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IN THE CITY OF NEW YORK

Volume XII]

JANUARY, 1928

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AMERICA AS A CREDITOR NATION

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE ANNUAL
MEETING OF THE ACADEMY OF POLITICAL SCIENCE IN THE
CITY OF NEW YORK, NOVEMBER 18, 1927

EDITED BY
PARKER THOMAS MOON

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PREFACE

ANNUAL MEETING (FORTY-SEVENTH YEAR) OF THE ACADEMY
OF POLITICAL SCIENCE, NEW YORK CITY, FRIDAY,
NOVEMBER 18, 1927

A SERIES of eighteen papers and addresses dealing with varied aspects of the general subject, "America as a Creditor Nation," together with some informal discussion of points suggested by these addresses, provided the program of a most interesting and stimulating Annual Meeting of the Academy, which was held at the Hotel Astor in New York City on Friday, November 18, 1927. The addresses and papers presented at the conference, together with two papers read by title in the absence of their authors, are contained in this volume of the Proceedings of the Academy.

The three sessions of the Annual Meeting were all well attended, especially the closing session which was a dinner meeting and at which more than twelve hundred persons were present—an unusually representative and distinguished audience. The sub-topics considered at the three sessions were respectively (1) Foreign Investment Problems; (2) International Trade Relations; (3) International Finance and World Trade. While not at all exclusive, but on the contrary, intentionally overlapping and inter-relating, these three sub-topics were treated as rallying points and demonstrated the practical wisdom of the Program Committee in its analysis and constructive organization of the available materials that could be profitably considered in a one-day national conference.

The usual brief "Who's Who" concerning those who participated in the conference is given here in order to familiarize the reader with something of the background, experience and point of view of the various contributors to the meeting and to the pages of this volume.

JAMES W. ANGELL, Associate Professor of Economics in Columbia University, is a graduate of Harvard University, A.B., 1918; A.M., 1921; Ph.D., 1924. He served for a time as Instructor in Economics in Harvard University and is the

author of a volume entitled: *The Theory of International Prices.*

MR. ROLAND W. BOYDEN, A.B., Harvard University, 1885; LL.B., 1888, is now a member of the law firm of Ropes, Gray, Boyden and Perkins, Boston; a Director of the First National Bank of Boston, of the Quincy Market, Cold Storage and Warehouse Co., Boston, and of other corporations; formerly Unofficial Delegate of the United States upon the Reparations Commission.

MR. O. H. CHENEY is Vice President of the American Exchange Irving Trust Company, general office, 233 Broadway, New York City.

MR. NORMAN H. DAVIS, D.C.L., University of the South, 1921, was for some time interested in banking, sugar and other business enterprises in Cuba and in 1905 organized The Trust Company of Cuba of which he was President until 1917, when he became Adviser to the Secretary of the Treasury in connection with foreign loans. Dr. Davis was special United States delegate to Europe, 1919. He was the American member of the Armistice Commission, member of the Supreme Economics Council and Chairman of the Financial Section; Financial Adviser to President Wilson and the American Commission to Negotiate Peace. He was also a member of the Reparations and Financial Commissions and from November, 1919, to June, 1920, Assistant Secretary of the Treasury in charge of foreign loans; Under Secretary of State, June, 1920, to March, 1921, during part of which time he was also Acting Secretary of State, and in 1927 he was an American delegate to the International Economic Conference at Geneva.

MR. OSCAR KING DAVIS is a newspaper man by profession; A.B., Colgate University, 1888; A.M., 1892; Litt.D., 1914. He served as a delegate from the United States to the First Pan-American Postal Congress in Buenos Ayres in 1921 and as Vice President of the Congress. Since 1917 he has been Secretary of the National Foreign Trade Council and has taken an active part in the direction of its investigations and discussions in connection with the annual conferences of the National Foreign Trade Council, whose headquarters are at 1 Hanover Square, New York City.

MR. LOUIS DOMERATZKY is Chief of the Division of Regional Information of the United States Department of Commerce, Washington, D. C.

PROFESSOR HERBERT FEIS is David Sinton Professor of Economics in the University of Cincinnati, has for some time been interested in the study and investigation of the problems of labor and industry. He has published a number of articles, monographs and books, among which may be cited an article in the *Quarterly Journal of Economics*, August, 1923, on the "Kansas Court of Industrial Relations, its Spokesman, its Record"; "International Labor Legislation in the Light of Economic Theory", *International Labor Review*, Geneva, April, 1927, "The Export of Capital in Foreign Affairs", etc.; and a volume entitled: *The Settlement of Wage Disputes*, 1921, Macmillan Company, New York; also a *A Collection of Decisions Presenting Principles of Wage Settlement*, which he edited with introductions, 1924, H. W. Wilson Co., New York. He has recently been engaged on an extensive study and investigation of foreign capital investments under the Simon Guggenheim Foundation.

MR. LEWIS S. GANNETT is Associate Editor of *The Nation*, New York; a graduate of Harvard University, A.B., 1913, A.M., 1915; author of a pamphlet, "Young China", and contributor of articles to *Century*, *Harpers*, *Current History*, *Asia*, and other periodicals. He was formerly American correspondent of the *Manchester Guardian*.

HON. CARTER GLASS, United States Senator from Virginia, is a journalist by profession but has long devoted his major energies to public life in his own State and in Congress. He was Secretary of the Treasury from December, 1918, to November, 1919, when he resigned, to be appointed United States Senator for an unexpired term and at its expiration was elected for another term.

MR. THOMAS W. LAMONT, A.B., Harvard, 1892; LL.D., Union College, 1921, is a banker by profession and has been a member of J. P. Morgan & Company since 1911. He was a representative of the United States Treasury in connection with the American Commission to Negotiate Peace, Paris, 1919, and

- has occupied many important official and unofficial positions in international finance; he served as Chairman of the American group of the International Consortium for Assistance of China and of the International Commission of Bankers for the adjustment of the Mexican foreign debt.

MR. WALTER T. LAYTON, M.A., C.B.E., C.H., Companion of Honour, 1919, Editor of the *Economist*, London, England, since 1922; Director of Welwyn Garden City and National Mutual Assurance Society; formerly Member of Munitions Council; Director of Economic and Financial Section of the League of Nations and Director of National Federation of Iron and Steel Manufacturers. Mr. Layton was a member of Trinity College, Cambridge University, and Fellow of Gonville and Caius College, Cambridge, 1909; University Lecturer in Economics, 1912; Newmarch Lecturer, University College, 1909-12. He represented the Ministry of Munitions on the Milner Mission to Russia, 1917, and the Balfour Mission to the U. S. A., 1917. He is the author of *An Introduction to the Study of Prices; Relations of Capital and Labour*; and various articles in reviews and journals. He was Chairman of the Committee that prepared the agenda for the World Economic Conference in Geneva and one of the British delegates to that Congress.

MR. RAY MORRIS, B.A., Yale, 1901; M.A., 1903, is a banker by profession and was a member of White, Weld & Co., New York, 1910-20 and has been a member of Brown Brothers & Co., New York, since 1921. During the world war he was connected with the Federal Reserve Bank. He is the author of a book on Railroad Administration (1910) and has contributed frequently to current magazines including the *Atlantic Monthly*, *Yale Review*, *World's Work*, etc., on economic and transportation subjects.

MR. WILLIAM WALLACE NICHOLS is an engineer by profession, whose early experience was with the motive power department of the C. C. C. & St. L. Ry., 1885-86; and with the C. B. & Q. Ry. as engineer of tests, assistant master mechanic and superintendent of telegraph, 1886-90; he was superintendent of the Chicago Telephone Company, 1890-93; instructor

in mechanical engineering at Yale, 1895-1900; works manager of the Baltimore Copper Works, 1900-04, since which time he has been with the Allis-Chalmers Co., as Vice President, 1904-13, and Assistant to the President since 1913. He has published many articles on engineering education and on foreign trade and is at present President of the American Manufacturers Export Association and Chairman of the Tariff Committee of the National Association of Manufacturers.

DR. EDWIN G. NOURSE, formerly instructor in Finance in the Wharton School of Finance and Commerce, University of Penna., 1909-10; Professor of Economics and Sociology in the University of South Dakota, 1910-12, and in the University of Arkansas, 1915-18; then Professor of Agricultural Economics in Iowa State College, and Chief of Agricultural Economics section, Iowa Experiment Station, 1918-23; since which time he has served as Chief of the Agricultural Division of the Institute of Economics, Washington, D. C. Author of *Agricultural Economics* (1916); *Chicago Produce Market* (1918); *American Agriculture and the European Market* (1924) and has been editor of *Journal of Farm Economics* since 1925.

PROFESSOR G. B. ROORBACH has been Professor of Foreign Trade at Harvard University, 1919 to date; he has the degrees A.B., Colgate, A.M., Univ. of Penna., S.D., (Honorary), Colgate University, and is the author of *Import Purchasing*, Chicago, A. W. Shaw Co., 1927.

During the war Dr. Roorbach served in the Division of Planning and Statistics, U. S. Shipping Board. He made a special investigation of conditions in Latin America (1915) for The Carnegie Endowment for International Peace, and was Special Expert, U. S. Tariff Commission, 1921, and Chief, Research Division, Bureau of Foreign and Domestic Commerce, Washington, 1921-22. In 1926-27 he was on leave of absence studying trade and economic conditions in the Far East.

PROFESSOR JOSEPH SCHUMPETER is Professor of Political Science in the University of Bonn, Germany, was formerly Minister of Finance in Austria (1919), Exchange Professor, Columbia University (1913), and Visting Professor, Harvard University (1927).

PREFACE

HON. JEREMIAH SMITH, JR., is a lawyer by profession; A.B., Harvard, 1892; LL.B., 1895. He was Secretary to Justice Gray, of the U. S. Supreme Court, 1895-96, and has practised law in Boston since 1896 where he is now a member of the law firm of Herrick, Smith, Donald and Farley. He served with the American Commission to Negotiate Peace as counsel to the Treasury Department and as adviser on financial questions. He was Commissioner General of the League of Nations for Hungary, 1924-26, in charge of the financial reconstruction of Hungary.

MR. JOSEPH R. SWAN, A.B., Yale, 1902, is a banker by profession and was for many years with Kean, Taylor & Co., New York. During the world war he was active in Red Cross service and at the close of the war became connected with the Guaranty Trust Co., New York, as Vice President, which position he now holds.

In the absence of the Managing Editor, Professor Parker Thomas Moon, on leave in Europe during the first semester of this academic year, the Chairman of the Program Committee and the Executive Secretary, Miss Ethel Warner, have assumed editorial responsibility for seeing this volume of the PROCEEDINGS through the press.

The Chairman desires to take this opportunity, on behalf of the officers and trustees of the Academy, to express their grateful thanks to the members of the Program Committee, and the speakers at the Annual Meeting for the service they have rendered the Academy.

SAMUEL McCUNE LINDSAY, *Chairman*

ETHEL WARNER, *Executive Secretary*

JOHN G. AGAR	ALEXANDER DANA NOYES
NICHOLAS F. BRADY	WILLIAM L. RANSOM
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OGDEN L. MILLS	PAUL M. WARBURG
DWIGHT W. MORROW	OWEN D. YOUNG

Committee on Program

PART I
FOREIGN INVESTMENT PROBLEMS

THE WORLD'S PRESENT AND FUTURE DEMAND FOR CAPITAL

JOSEPH R. SWAN

Vice-President, Guaranty Trust Company, New York

I HAVE been asked to discuss very briefly from the point of view of the practical banker a subject that covers a wide area and a long period. I shall be able to pass only lightly over important subjects and shall try to present to you a fairly broad, but very impressionistic picture of the field of international finance as it now appears. For the purpose of this discussion the world demand will mean the international demand and will not include those domestic capital demands which are filled at home. The present will be the period of time from the ending of the war up to the present. The future will be a very indefinite period extending an uncertain distance ahead of us. Capital, for which various definitions may be given, in this case will be wealth from which its owners expect to receive an income, and is for the most part represented by promises to pay in the form of bonds, or by evidences of ownership in the form of shares. As the banker uses the word, capital is surplus income collected in large and small amounts from the people and corporations and investment trusts of the city, the town and the village, and directed here and there in the world to assist nations to rehabilitate their factories, homes or fields, to balance their temporarily disarranged budgets, or to extend their public works; to make it possible for railroad, public utility and industrial corporations to extend their facilities, or for the empire builder to open up and develop unused natural resources. There are two major requisites which capital requires from the borrower. He must offer a satisfactory rate of interest and must command confidence.

Up to the time of the Great War this country was little interested in foreign investment. We had placed comparatively small amounts of capital in the nearby countries of Canada, Mexico, Central and South America, but ours was a partly developed country where interest rates were attractive, and our

public did not have to seek far to find a field for investment, nor did we have sufficient knowledge of foreign countries to feel confidence in their credit. The financial capital of the world was London, as it had been Amsterdam previous to the Napoleonic wars; while France, Germany, Holland, Switzerland and Sweden also contributed large sums to the international markets. America was a debtor nation. It was in a moment of time, however, that we became the principal money market of the world. There were many factors which contributed to this sudden change. Our immense exports during and after the war, our newly formed Federal Reserve System, which so greatly expanded our credit facilities, our Liberty Loans which taught us how to mobilize our resources, combined with the advanced state of our own development, and our newly acquired knowledge of the world, all helped to make it possible for us to take advantage of the exhaustion and financial chaos which almost everywhere else existed.

During 1918, while the war was in progress, international demands were financed by the national government, but immediately upon the conclusion of the war the banker resumed his occupation of trying to meet the requirements of needy borrowers. During 1919, some \$550,000,000 of new foreign loans were issued in this market to borrowers of the very highest credit, namely, Great Britain, Canada, Switzerland and Scandinavia, with very scattering amounts to Latin America. The real problem of post-war finance, that is the rehabilitation of nations whose resources and credit had been most seriously affected by the war, was not touched. It was out of a bank credit to Belgium to purchase wheat that the first effective effort in this direction developed. Belgium, of course, was starving. Short-term credits totaling \$50,000,000 had been arranged so that the Government could buy wheat and other essential commodities. When these credits began to mature the franc had declined from a gold value of 13 cents to 7 cents. To repay these gold credits of \$50,000,000 by the purchase of exchange in a franc worth half of what it was worth when the credit was granted seemed impossible. Bankers who had arranged the credits were approached by the government and asked in the emergency what could be done. The bankers didn't know. Perhaps they could float a loan of \$25,000,000.

They would do what they could. After long and careful deliberation, a loan bearing 7.5 per cent interest, payable by lot at 115 over a period of twenty-five years, was agreed upon. Every resource of publicity was used, and finally, urged on by the feeling that the sympathy of the American public would respond to Belgium's appeal for aid, in June, 1920, a nationwide banking group, composed of the strongest banks and bankers in the country, was organized to issue \$50,000,000 bonds. The subscription books were kept open for three days, a very unusual procedure; every resource the banker could command was used to induce subscription, and finally the books were closed with a subscription of \$53,000,000. The loan was over-subscribed and a very vital step forward in our entry into the field of international finance was accomplished. Loans to France and Italy soon followed and then the first industrial loan to Belgium. The work of rehabilitation was begun and has continued up to this time. In 1921 there were additional loans to France and Belgium, and a largely increased demand from Latin America. Australia was added to the list of borrowers, and 1922 added Czechoslovakia, Netherlands, Jugoslavia, Dutch East Indies and the first corporation loan to France. In 1923 came the first loan fathered by the League of Nations, that to Austria, also loans to Finland and Japan. During 1924 were made the first loan to Germany to consummate the Dawes Plan and League of Nations, loans to Hungary and Greece, a large loan to Japan, and the first loan to Japanese electric light and power companies. In 1925 there were very heavy loans to German states, municipalities and industries; the first Italian industrial corporations of importance borrowed here, and there was heavy borrowing by Japanese public utilities. In this year Holland, Switzerland and Sweden, who had been heavy borrowers, did not appear and began to repurchase their own dollar securities. Nineteen twenty-six added Bulgaria and Luxembourg to the list of borrowers, and 1927, Estonia and the Free State of Danzig. So that now a very large majority of the nations of the world are our debtors, and several who are not would like to be.

Looking back over the period from 1919 to the present, financial progress seems to have been made very normally during very abnormal times. At the beginning of the period lack of

confidence in European stability and credit, and lack of knowledge of world finance, was combined with the fact that every credit facility of the country had been employed to aid in the prosecution of the war, and comparatively little investment capital was available. Canada, her provinces, municipalities, and industries were so well known to us that they could borrow on terms only slightly less favorable than the terms required of domestic borrowers. Among South American countries, Argentina, Chile and Uruguay were best regarded by American bankers. In the other hemisphere, the credit of England and her dominions, Scandinavian countries, Holland and Switzerland were rated highly, and so it was to them that our first loans were made. For other countries to obtain capital required courage and effort on the part of the banker, and it was the other countries, of course, who most needed assistance. The episode of the loan to Belgium was repeated time after time with other countries; in fact, with practically every new country which came to this country for credit. Every resource of the banker and the press have had to be used to familiarize the investing public with financial, economic and political conditions in France, Italy, Czechoslovakia, Yugoslavia, Austria, Hungary, Germany, Greece, Japan, the Dutch East Indies and the countries of Latin America. In each case the original borrowing has generally been for the national government. Once the financial condition of the country has become known and favorably considered, the municipalities and industrial corporations have quickly applied for and received the capital necessary to carry on the reconstruction planned and begun by the central government. Briefly, to tell of the history of the financial reconstruction of any one country by itself would take much more than the time allotted to me. There was borrowing to balance budgets before the political situations would permit of taxation sufficient to make income equal expenditure, and borrowing to transfer the floating debt from a country to us because the nationals did not have sufficient confidence in their own country to renew their short advances; there were the over-issue of bank notes, the depletion of bank reserves, the unfavorable balance of trade, each factor a problem in itself; finally there was a reconstruction programme in which

each element was provided for and a loan, generally international in character, to provide gold cover, to help carry the budget until new taxes provided by the plan could be collected and confidence restored and capital repatriated. Finally, there were loans to states and municipalities for public works to provide employment, to mortgage banks for relending to farmers in order that food might be provided, and to private corporations to buy raw materials and to modernize their plants so that the industries of the country might compete with the industries of the world and restore a proper international balance of trade without which the nation could not exist. That is a short résumé of what has happened in many countries of the world in the last few years. In some the programme has been complete, in some the problems have been less in number, and the bankers' difficulties have thereby been diminished.

Consideration of this résumé will show that out of necessity many initial loans were for purposes far from productive, but that there has been a gradual progression toward loans of a productive character. In the early years after the war it could not have been otherwise. The nations had first of all to fund the carry-over from the war, and in many cases to find food for a starving population. Gradually, as the reconstruction has progressed, the capital supplied has come to be used almost entirely for productive purposes, and the banker is more and more requiring that this shall be the case. The period of financial reconstruction is now nearly at an end. The return of France and Italy to a gold standard at a not very distant future date seems not difficult of realization. There are still countries which need a doctor, but they are the smaller nations that do not so vitally affect the welfare of Europe. This must not be taken to mean that Europe has left her financial problems behind her. That is far from the case. Each country has immense problems; but they are, for the most part, problems that intelligence, industry and saving will solve.

The foregoing paragraphs have referred largely to Europe, but they are applicable to a lesser extent to Canada and to Latin America. They, too, had their post-war problems, their unbalanced budgets and their floating debts, but in general their borrowings were of a productive character sooner than

those of Europe. Nothing, of course, has been said of Russia and China. Their capital requirements in recent years have not been a cause of concern to the banker.

During the years under discussion we have publicly issued in this country, according to figures of the United States Department of Commerce, loans to foreign borrowers aggregating about \$7,000,000,000. Of this amount \$3,000,000,000 went to Europe, and of this approximately \$1,100,000,000 to Germany; \$1,500,000,000 were loaned to Canada, \$1,600,000,000 to Latin America, and the balance to the rest of the world. The above aggregate is regarded as a very conservative figure and some statisticians have compiled an amount considerably larger. The figure does not include enormous amounts of capital provided by domestic corporations in connection with the extension of their business in foreign countries, such as Armour, Swift, General Electric Company, Singer Sewing Machine Company, Ford Motor Company, Aluminum Company, International Paper and others too numerous to mention. The amount which has been expended outside of the country by such corporations is impossible to compile accurately and difficult to estimate. Some figures are as high as \$5,000,000,000. But it is probably little exaggeration to say that within the last eight years we have placed abroad \$10,000,000,000 of capital in every quarter of the world for every purpose. States, municipalities, mortgage banks, railroads, public utilities, industries of every nature; in Canada, paper, pulp, automobiles, aluminum; in Latin America, sugar, copper, nitrates, meat products, oil; in Europe, steel, electricity, fertilizer, chemicals, mining; from everywhere for every purpose demands have poured in.

Financial world reconstruction has not, of course, been accomplished with the aid of America alone. Always England has contributed her knowledge and experience, and, within an amazingly short time after the war, her money. Almost entirely by herself she has taken care of the financial needs of her dominions and her colonies, excepting Canada and some in Australia. In spite of her numerous war losses she has, during the last four years, shared largely in loans in all parts of the world, and though she cannot now be as lavish of her resources as formerly, she loaned externally during 1926 about £122,000,000. Holland, Switzerland and Sweden, to a lesser

extent, 'as soon as their exchanges permitted, shared in many international loans. We are, therefore, not alone as a lending nation, nor should we wish to be, but we have joined the list of creditor nations, and until some catastrophe changes the situation, will doubtless remain so. In all that has been accomplished during recent years, there has been constant and increasing cooperation among international bankers. It is earnestly to be hoped that this will further increase and continue. It will greatly aid in international understanding.

So far the discussion has tried to show how we have gone through a very abnormal period, whose end seems near; how in cooperation with other nations we are now lending throughout the world for productive purposes; and how we have come to the point where we must consider the future.

From the bankers' viewpoint, nations may be divided into three classes: developed, partly developed and undeveloped. Developed nations, under normal conditions, are not borrowers. The post-war period of finance will have ended when the developed nations cease to borrow. Germany must be excepted from this statement, as reparations make her position abnormal. Now if developed nations are not normally borrowers but lenders, it is obvious that demands for loans from many countries of Europe, to which we are now lending, will cease, and that our future demands will come from the partly developed and undeveloped regions of the world. The first thing we can count on in the future, therefore, will be to continue as we have now begun, to furnish capital to partly developed countries all over the world for their normal development, just as it was furnished to us by England and by other countries prior to the war. Loans will be made for purposes very similar to those for domestic loans, and it will be more or less easy to interest the public in them as the character of the domestic loans, which they resemble, is popular or unpopular with our investing public. Requests for capital for some traction companies may have difficulty, irrespective of their intrinsic merits. Power and light companies will find a cordial reception. Some fertilizer and textile companies may be inspected with great caution, while steel and electric manufacturing companies will meet approval. We will, also, doubtless directly, or through holding companies, acquire ownership of or an interest in,

various enterprises, as is contemplated by the American and Foreign Power Company, the International Telephone and Telegraph Company, or the International Match Company. In other words, we will share in the growth and development of various countries as we share in our own growth and development. The more accustomed we become to foreign fields the more varied will be our interests. Little by little as capital becomes more confident and experienced, we will join in the development of undertakings of a more hazardous character until we gradually become closely associated with the development of the undeveloped countries. The era after the Napoleonic wars was an era of world expansion of trade and industry made possible by the application of steam to industry, and by the opening up of new territory through the building of great railroad transportation systems in various parts of the world. Prior to the outbreak of the Great War, economic pressure was again exerting its influence towards various new railroad-building programmes of which the war, of course, prevented the completion. Now again, however, we see these programmes revived and extended. In North and South America, Africa and Australia important railroad projects are under way, carrying along in their wake the movements of population and the building of territories, which are a necessary adjunct of the projects. We can look forward to very great and immediate development of the character that followed the Napoleonic wars. Our capital will join in these new developments and doubtless in Africa we will help to consummate the dream of Cecil Rhodes of a Cape-to-Cairo railroad, or in some other part of the world will supply the capital for another Suez Canal, or a Nile Valley development.

Today, moreover, a number of elements combine with steam to make great developments possible. Vast areas, which were previously uninhabitable by white races, and some even by native blacks, are made available through the great progress of medical science in the control of sanitary conditions. American engineers succeeded in building the Panama Canal when the French failed, not because they were better construction engineers, but because they could control sanitary conditions. When the Belgians built the first railway past the falls of the Lower Congo, their laborers died like flies. Today they are

widening and improving the railway with little, if any, difficulty in that respect. There are other factors that must be considered of vital importance in modern development, three of them of a major character; electricity, the internal combustion engine, and the great improvement in technical processes of production, with particular respect to chemistry.

One of our prominent public utility operators has a conundrum which he is fond of asking. It is this: If a public utility company has gross earnings of \$30,000,000 a year, and these earnings increase at the rate of 10 per cent a year, and it takes \$4.50 of capital to produce each dollar of gross earnings, how much new capital will that company need in the next twenty years? I am not going to give you the answer to that particular problem, but I am going to apply it to the power and light companies of the country, as a whole, and the answer is that on that basis over a period of the next twenty years they will require \$65,300,000,000 of new capital. So that you may not feel that this figure is too fantastic, I will say that during the last eight years the gross earnings of the electric power and light companies of the United States increased an average of more than 11 per cent a year and \$4.47 was required to produce \$1.00, of gross revenue. Remember that the rest of the world is far behind us in the use of electricity. Apply this formula, and assume that they will try to catch up to us, and see where it leads, and then add to power and light companies, telephone companies, telegraph companies, radios and the other vast uses of electricity.

The internal combustion engine probably spells to all of us automobiles, trucks, busses, tractors and aeroplanes, in spite of its countless other uses. There are in this country 22,000,000 automobiles, trucks and busses against 5,500,000 automobiles, trucks and busses in the rest of the world. From the point of view of capital demands, visualize only the amounts required for road construction, which would be necessary outside of countries where good roads now exist, if a small percentage of our requirements at some time seemed necessary to the rest of the world. As for improvement in technical processes, one has only to consider the constant stream of visits to this country by committees of foreign industrial experts to study our manufacturing methods, and the loans which have

been made by us to various industries to rebuild their plants in order that they might place themselves in a position to compete for world trade. Or one might mention an expenditure by the Bethlehem Steel Company of \$150,000,000 during the last four years almost solely to reduce costs, not to increase tonnage. Another good example is the fact of Germany's imports of nitrates before the war to the amount in 1913 of 775,000 tons, while today she exports more than she imports, and the consequent damage to the Chile nitrate companies who are now, on their part, developing a process which will permit them again to produce their product on a most favorable competitive basis. And there is the distillation of coal for oil, now apparently commercially profitable in Germany, and a thousand and one other things each tending to economy, but requiring capital to install.

There is one last demand for capital which requires consideration and it is a most agreeable one. It is the demand created by the improvement in standard of living, occasioned by industrial progress and world development. It needs no words to describe to you the character of this demand. You, who live in a surrounding in which the standard of living is the highest the world has ever known, see it all around you.

One more word. Bankers are often regarded as pretty hard individuals. Some of them are, but I should hope rather that they might be thought of as trying by caution and sound judgment to safeguard the interests entrusted to their care. Upon them falls much responsibility for the uses to which capital is put. It is not an easy task to guide it into productive channels; and one sees every day, on every side, failure of individuals and of corporations to do so. The great steel companies of this country with their experienced and efficient managements, in normal times earn less than six per cent on their invested capital. In these years which are before us it is going to take knowledge, judgment, caution and patience on the part of both bankers and investors in order that America may intelligently accept her responsibilities and reap fully the benefits of her position as a creditor nation.

THE RELATION OF FOREIGN INVESTMENTS TO THE FLOW OF WORLD TRADE ,

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“THE Relation of Foreign Investment to the Flow of World Trade” is a subject which comprehends, in my judgment, much more than can be fully discussed in one such paper as mine. Consequently, I am going to take the liberty of narrowing its scope somewhat materially. I shall consider that what the Program Committee really had in mind was American investment in other countries, and its relation to the American export trade, and that it did not desire an attempt at consideration of the whole field of British, French, Dutch and other investments in Bolivia, Chile, China and all the other hundred and odd territorial divisions of the world, with any consequent effect such investments might have upon the imports and exports of all of them combined.

It is sufficiently intricate, complicated and difficult, even with this limitation, to set forth anything that is susceptible of real proof and that warrants a statement of positive and fair conclusions. Vast volumes of words have been uttered, written and printed on this theme. A considerable variety of opinion has been expressed. Much more than a modest modicum of contention has been aroused, chiefly, it seems to me, by the lack of precision with which one side or the other, or both, have set forth their views.

It has been attended, moreover, by one spectacle which, to me at least, has been both amusing and irritating. There has been a tremendous tearing to pieces of straw men. The destruction has been incalculable. I doubt whether the joy this has rendered the destroyers is sufficient compensation for the waste of good straw.

The discussions of these meetings ought to deal with a maximum of fact and a minimum of assumption. But the debate of the investment and trade question has partaken very

largely of the chief feature of the average tariff talk, assumption of the *post hoc ergo propter hoc* variety.

Certain facts stand boldly forth in the trade and investment records of the United States for the last twenty-five years. Take South America, for illustration. In 1890 only 10 per cent of South America's imports came from the United States. At that time our investment in the southern half of the western hemisphere was little better than negligible. In twenty years, that is, just before the outbreak of the world war, our trade had grown so that we were supplying about 14 per cent of South American imports. Our investment there had expanded to about one hundred millions in the same period.

But in 1925, the last year for which we have the full trade figures, we supplied more than 28 per cent of South America's imports. And our investment there had grown to something like one and a half billions. We are selling merchandise to South America today at the rate of more than a billion a year.

Consider Central America. In the four-year period from 1910 to 1913 we furnished, on the average, fifty per cent of Central American imports. Today we are furnishing more than sixty-five per cent of them. There, too, our investment has grown to well over a billion, and is approximately, barring recent financing, equal to the figures for South America.

It is to be noted, moreover, when considering these percentages of their imports, that total imports for both Central and South America have increased enormously during these years, save that the actual gain in volume of trade is much larger than the mere percentage figures show.

It is difficult to deal in general terms with our capital advances to South America. In the Argentine and Brazil, for instance, such advances have largely taken the form of loans to national governments, provinces and municipalities, with little, if any, accompaniment of American managerial participation. In both these countries there has been a certain amount of private American investment in productive enterprise, with a certain measure, sometimes complete, of American managerial supervision on behalf of the investors.

In Chile, on the other hand, private investment has been a very large factor in American capital advances, notably in the copper and nitrate fields, and loans to government or municipalities are probably subordinate in volume.

But in all these countries both loans and private investments have surely helped to increase purchasing power, immediately or remotely, and consequently have tended to stimulate trade.

Now take a brief glance at Cuba. In 1902, when we set up the first free government for that country, she had a population of just over 2,000,000 and a total trade of about \$70,000,000. Today her population is about 3,000,000, a gain of 50 per cent. But her total trade is over \$600,000,000, a gain of something like 700 per cent. Meanwhile, American investment in Cuba climbed to the colossal figure of a billion and a half, approximately equal to that in all of South America, or all of Central America.

These figures begin to look like proof that investment is a trade developer, but they are by no means the whole of the story. If I were to attempt to deal technically with my subject I should start, I suppose, with an analysis of the term "foreign investment" to try to see exactly what it means: loans, flotation of securities, individual purchase of securities, or individual purchase of property intended to be productive in some way, loans by one government to another, by banks to a government, by banks to banks, or by banks to corporations, and so on. It would require very much more time than I have been able to give, to prepare such an analysis, and the rest of this month, probably, to present it.

American investment, as I shall use the term here, means rather the putting of capital into productive enterprise by men who expect to participate in the management of that enterprise directly or by representatives, and to profit from the result, rather than the purchase of bonds or stocks by investors who want to put their savings where they believe they will get a sure and safe return without having to bother to look after the business all the time.

Precisely that, as I understand it, is the character of the great part of American investment in Cuba. It has gone into enterprises that increased the productivity of Cuba and facilitated the trade in the products. Such investment, it seems to me, is always bound to increase trade. Cuba, for instance, has produced very much more sugar, because of those American dollars, than she ever would have made without them. In a case of that kind the relationship between foreign invest-

ment and the flow of world trade is direct, immediate and plain.

But the cases are by no means all of that kind. . . Foreign investment is a thing of infinite variety. It ramifies all across the horizon, and at the other pole from the Cuban case cited we have such a case as the famous Tijuca Drive about Rio. The lenders of the ten or fifteen millions of borrowed American dollars which built that beautiful drive will have to search long and earnestly to discover any way in which that road earns a nickel toward the service of the loan. This helps illustrate, also, the difference between an investment, of the Cuban sort I have been talking about, and a loan. If the American lenders of the money that built the Tijuca Drive had been investing it in the enterprise for themselves, instead of the bonds of the city of Rio, they would have made it a toll road with charges high enough to get interest and amortization.

Loans, however, are probably seldom as unproductive as that which built the Tijuca Drive. Even loans to governments and municipalities, go for the most part, I presume, into something that yields some kind of return with which to meet the service obligation. And so, presumably, most loans also have their effect in stimulating trade. It seems a fair assumption.

But proof is a different thing, and if anyone is inclined to accept the fact that the trade of a country to which foreign loans have been made, or in which foreign investments have been placed, has expanded thereafter, as proof that the loans or investments caused that growth, he is likely to meet some cases that will give him a little pause. For instance, Americans have loans and business investments in China to the aggregate of seventy million dollars. These are intended and supposed to be directly productive. We also have uplift investments in China, for missions, schools, hospitals, and the like, aggregating \$80,000,000, remotely and indirectly, if at all productive. Now the total of foreign loans and investments in China is about \$2,500,000,000; that is, six per cent of the foreign investment in China is American, counting both business and uplift. But we have over eleven per cent of China's trade, and it has made, roughly, the same forward strides in the last twenty years that our trade with other parts of the world has made, including some parts where our in-

vestment has grown with great rapidity and is now very large in volume. Which is only another way of saying and showing that even though loans and investments may be a strongly influencing factor in trade stimulation, perhaps even the chief factor, there are other factors which must be taken into account, and some of these obviously have been at work in China.

From the point of view of the lender or investor it is true, of course, that loans and investments have a direct effect in producing exports. No new discovery in economics is announced in the statement that the proceeds of a foreign loan floated in this country, and the capital of American investments in other countries go abroad as merchandise exports, of one sort or another at one time or another. I will not pause here to discuss the gold and service alternatives. It seems sufficiently precise to say that every foreign loan and all foreign investments probably mean merchandise exports.

And here we come to that deadly field so widely and thickly strewn with the mangled remains of our straw men. For there is a great difference of opinion between industrialists generally on one side, and investment bankers and certain professional economists on the other, as to the trade-producing effect of foreign loans, and particularly as to whether or not the full potentiality of such trade stimulants is always evoked by the investment bankers in arranging such loans.

Here is where the general-in-chief of the army of straw men, Field Marshal Tying-in Clause, advances majestically upon the line of vision. He is a fellow of at least double, and perhaps treble appearance. To the average investment banker, loan underwriter, or professional economist, he is of frightful and forbidding mien, and possessed of menacing, if not lethal potentialities. But to some industrialists, though I am glad to be able to say advisedly, not to all industrialists, he is a figure of mildness and hope, filled with possibilities of great things. Very likely one opinion is as good as another about this figure which has been the center of so much discussion in this country since the United States became a creditor nation. Both have points of merit and both have points of no merit.

I will not pause to define the tying-in clause. No doubt everyone in this room fully understands it. I merely say that I personally hold with the fairly large group of American

business men who believe, that although there are many cases of loans to which the tying-in agreement, whether by specific stipulation in the loan contract or by understanding reached during the loan negotiation, is not applicable, and should not be used or sought, at the same time we believe that there are cases where it would be applicable, where the understanding might be reached, and where continuing benefit to American trade would result. And we ask our investment bankers always to have this possibility in mind when they are negotiating a foreign loan, and to see to it that if the possibility does exist, it is not neglected.

Now I submit that that position is very different, essentially, from what the investment bankers and some professional economists habitually describe as the demand of the industrialists. I have heard scores of speeches and read more scores of articles and hundreds of editorials in which speakers and writers asserted that the demand, if you please, of the industrialists, is for use of the tying-in clause as a condition precedent to the granting of any foreign loan.

That is a straw man, and nothing more. During the six or seven years in which I have been giving considerable attention to this subject, I have known only one American industrialist to advocate even the general use of the tying-in clause, and none to advocate it as a condition precedent. The subject has been presented to each of the last five or six National Foreign Trade Conventions, and from each has come the same declaration, asking the investment bankers always to keep in mind the possibility of promoting our foreign trade, *and whenever they find it feasible* to arrange, if they can, for expenditure of part of the loan proceeds in the United States.

Why the bankers and economists habitually ignore this reasonable position in their public utterances I do not know. Why they seem always to feel it necessary to trot out the "condition precedent" straw man and furiously tear him to pieces I can never imagine. But that is precisely what, for the most part, they do. I once heard one of our most distinguished investment bankers, a great authority on foreign relations, deliver a vigorous argument for half an hour on the folly of trying to enact a law to make the tying-in clause a condition precedent of foreign loans, and when I asked him who advocated

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such a law he could not, or at least did not, name a single person.

There is another straw man whom the banker-economists love to parade. That is the proposition that use of the tying-in clause would force the poor defenseless borrower to buy what he needs, in the most expensive market, to his great disadvantage. We have all heard that alleged argument until we can say it backward in our sleep. What I want to ask the makers of this argument, and I am glad to have this opportunity of doing so, is why they habitually assume that the United States is the most expensive market in which foreign borrowers of our dollars can buy, and why they habitually assume that if the foreign borrower does buy here, he does so to his own disadvantage.

These questions at once lead to several more. One of them is, what attention do the users of this argument pay to the trade figures of the United States, and how do they explain them? How does it happen that if this is the most expensive market, and foreigners buy here to their disadvantage, they keep on buying here, year after year, in increasing numbers and expanding quantity? We are exporting today, and for years have done so, many millions more than any other country on earth. By far the largest single class of our exports is finished manufactures. If we take in finished and semi-finished manufactures, and manufactured foodstuffs, we have about two-thirds of our total exports, and that total runs close to five billion dollars a year. It requires 1,183 categories in the Department of Commerce statistical records to give the different classes under which American goods are exported, and the statisticians have to do some very strong-arm grouping to keep the list from being much larger. If the foreign buyers of even a small portion of all these exports are buying to their own disadvantage, all I can say is that a tremendous number of poor devils all around the world are getting badly stung.

But, of course, they are not buying at a disadvantage. They are buying at a great advantage. No one knows it so well as they. That is why they keep coming back for more. That is why our exports keep growing. That is why we sold more to Latin America last year than England, France and Germany combined, sold. That is why their percentage of

that trade is going down while ours is going up. That is why they are promoting the most vicious anti-American propaganda throughout South America that has ever been seen, and that is why this furious propaganda has not dented our trade.

But I hope the straw men are nearly all used up. Before long, I hope, the discussion, if it has to continue, will get down to the real facts in the case. Imagination, fancy and prejudice will play smaller parts.

New foreign loans, it may be taken for granted, mean new exports. New foreign investment may, and probably does, mean new exports. The point I urge is that if the loan underwriters and investors have the will to help build up our foreign trade, and keep the possibility in mind when lending or investing, they may occasionally, perhaps often, shape matters so that continuing exports will follow the new ones. And that is the heart of the matter.

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RELATION BETWEEN REPARATIONS AND THE INTERALLIED DEBTS

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upon the Reparations Commission

THE foreign governments which are our debtors have always insisted upon the close relation between reparations and their debts to us. They have always wished and tried to have them discussed and settled together. The United States has consistently refused to admit the relation or to permit them to be discussed or settled together. We have so far refused ever to put into our debt settlements the so-called "safeguard" provisions—i.e. the provisions which call for reconsideration, if Germany fails to pay, or if exchange stability is endangered.

There are two fundamental reasons back of this stiff attitude of our government. They practically determined that attitude in the beginning, and they are influential now. First, recognition of the relation had a strong tendency to make reduction, perhaps cancellation, of our debt necessary. We knew from the beginning that the reparation debt was absurdly high and must somehow and sometime be reduced. If the two were considered together, inevitably reduction of our claim must be considered. Second, recognition of the relation tended to make us the indirect creditors of Germany. To put it concretely, our government wanted to collect from France or Belgium, but did not want it to appear plainly that their pressure upon Germany was based in any measure upon pressure upon them by the United States.

The Allies, our debtors, on the other hand, thought that our money contribution should be regarded as part of the united effort to win, and should not be collected at all. They had doubts of their ability to pay, if they collected reparations, and felt sure they could not pay, if they didn't collect, and the thought of paying their own foreign war debt in full and canceling in whole or part Germany's war debt to them was intolerable.

The United States therefore always vetoed any suggestion of considering the two things together. This veto was a very serious factor in retarding a sensible reparation settlement. There were other serious factors, so that no one can really say that the Dawes plan—or some other solution—might have come earlier except for the United States' veto. But we failed to help in this obvious way, although we were urging the Allies to reduce the reparation debt to a sensible figure, a position which always seemed to them inconsistent and unfair. The Allies were gradually forced by other factors to the solution, the Dawes plan, without our having yielded upon this point. And in the solution we insisted upon and obtained on account of our legal claims a part—not too large, if we were to take any—of the Dawes plan payments, reducing thereby the sums coming to the Allies, already utterly inadequate to compensate for their losses.

Then (excepting Great Britain) we used our power over private international loans to force our friends and Allies to walk up to the captain's office and settle with us and we did this, in the case of Belgium and France, at a time when their financial condition was most critical and difficult. The French settlement negotiated at this time has not yet been accepted by France.

In those settlements, we adopted capacity to pay as a basis, which is a great advance upon our former position of no cancellation whatever, though it is a mistake to regard it as a real concession. It is not a concession to give up something which it is impossible to get. But our estimate of their capacity is on a basis which is liberal to them, if we assume that reparations are to be paid the Allies as provided in the Dawes plan, so that our settlements do constitute in effect a slight concession.

But our attitude, on the whole, has been such that this concession, whatever it is, and our leniency, not wholly voluntary, during the period preceding the settlement, count for little or nothing in the general impression we have made upon our friends and partners in the war. And in my own judgment we have not yet come anywhere near doing the fair thing. Take the case of France, for instance. If the situation were reversed, if France were in our position, and if we had been through what France has been through, and were now in the

position in which France is, we should feel that France was a terribly hard creditor and had failed to take into account elementary principles of fairness. Our general public opinion has never been educated to this point of view. About all it knows is that France owes a debt which it does not pay.

Without arguing the question of fairness in detail, I insist on emphasizing here one point which has been almost wholly ignored, i. e. that the burden which payment imposes upon our friends, who are our debtors, is far greater than the benefit of the payment to us. A dollar means more to them than it does to us.

I should like to see our attitude changed, particularly with respect to France, which has not yet made a settlement, but it is difficult to see how this change can be brought about now. There will certainly be an opportunity sometime in the indefinite future, and it is of that opportunity that I wish to speak at the moment.

Leaving out of account the possible increase of the German annuity under the Dawes plan, the top figure of her annual payment will be about \$600,000,000. The principal of her reparation obligation is still \$32,000,000,000. So that the annuity is only two per cent interest with no amortization of the principal, and there is at best some doubt of the possibility of transfer of the two per cent, though I see no reason to doubt that Germany can pay the marks to the Allies. In theory, these annuities continue indefinitely.

If time and experiment prove that the transfer cannot be made, then some modification of arrangement must come. Whether the transfer of the annuity can be made or not, it is obvious that some time the principal of the reparation debt must be made to correspond with the possible annuity, and that the final end of the annuity must be fixed. It is of no use to agitate this question at present, even for us, and for Germans to do it as they occasionally do, is pure folly. Time and the facts will bring it about.

But when that time comes, our attitude toward our claims against the Allies will again be important. If we stick to our theory that there is no relation between reparations and interallied debts, and refuse to help when the time comes, we shall again be an obstacle to the clearing up of international

relations, and increase the impression among our debtors of our hard-heartedness, and our unwillingness to bear a fair share of the war burden.

What are some of the factors which relate reparations to the interallied debts?

First, both reparations and interallied debts grow out of the war. Both make good in part war losses and payments. We almost ignore this relation. In the case of reparations we have no doubt that the obligation is just, though there would be much difference of opinion as to why it is just. In the case of the debts, the fact that our payment took the form of a loan is our basic, probably our only, justification. We have to ignore any comparison of losses and suffering. We have to ignore the comparison between our own financial strength and our debtors' weakness. The best we can say is "You owe the money, you must pay as much as you can".

Second, reparation is an asset of our international debtors. As such an asset it is inseparably wedded to their ability to pay us. Before our settlement we hardly admitted even this obvious relation; but we can now, and do, point with some satisfaction to the fact that our important creditors can pay us out of their reparation payments. We do point this out, though we still refuse to recognize the relation in its most important aspect to them. We still refuse to admit a possibility of revision of our demands if reparations are not paid. And in all this we ignore the fact that reparations ought in justice to go first to repair not our own losses, but the far more serious losses of our allies. We are taking, on account of our debt, money that ought to make good such things as the devastation in France and Belgium.

Third is the fact that they are tied together to some extent because of their relation to and their effect on exchange. And anything which affects exchange seriously is tied up with everything else related to exchange, an international spider's web of exports and imports, trade balances, international and national price levels, gold reserves, balancing of budgets, currency stability. So reparations and interallied debts really are married and there is no possibility of divorce.

There are some very striking illustrations in the arrangements our debtors have themselves made of the inevitable tendency to

relate the two. The Italian Government has continued a *Caisse d'Amortissement* into which go all receipts from reparations and which is to be devoted to payment of its war obligations. They cannot afford to devote this money to repairing or recouping their losses at home. Great Britain makes its demands upon Germany and the Allies dependent upon the amount of the United States' demands upon Great Britain. France and Great Britain accepted German obligations in payment of part of Belgium's debt, which we also were to do under Wilson's arrangement which we never ratified.

In speaking of reparations, one naturally thinks almost wholly of Germany, but the fact that other countries are subject to a reparation burden ought not to be forgotten. Austria, for instance, has been rehabilitated by the League Relief Plan, but her reparation burden was not removed. It was postponed for twenty years, and in fourteen or fifteen years Austria and the world will again be face to face with it.

As I have said, our government has refused to discuss reparations and the Inter-allied debts together, largely because such discussion tended inevitably to put the United States directly or indirectly in the position of a creditor of Germany—directly if we should take reparation obligations in payment—indirectly, if the payments to us were made to depend on the amount of Germany's payment to the Allies.

And yet in substance that is just what is going on today. The United States is to a considerable extent substituting German obligations to the United States for Germany's reparation obligations to the Allies. This is going on not through Government operations, but through non-governmental channels. The flood of our long-time loans, our short-time advances and the credit given to Germans by our exporters, is in part supplying the exchange which Germany uses to pay reparations to the Allies. Incidentally, we should have been making the same sort of advances to France, if the United States Government had not placed an embargo on loans to France, in order to force France to settle with the United States. Within reasonable limits this is sound. It is the thing which helps to make our exports possible. The fact that it is helping to make transfers under the Dawes plan possible also makes it desirable. But it is both interesting and amusing

to see that our advances are helping to pay reparations and that reparations are at the same time helping to pay our other loans.

To how great an extent can this process be carried and still be desirable and safe for Germany or for our investors and exporters? I do not pretend to know the answer. I can see that a considerable part of the huge total of advances to Germany in which other nations as well as ourselves participate, constitutes a quick call loan payable by Germany in foreign exchange, and that every item of it, however long deferred by its terms, nevertheless may at any time translate itself through attempts to realize into an indirect but practically quick call on Germans for foreign exchange. So long as exporters and bankers renew credits and investors retain confidence, this call on Germany will not be made. But we might need the money, or a severe shock to Germany's international credit might be followed by this call. Neither Germany nor the outside world in general, nor the countries interested in payment of reparations can afford to have this possibility of a call upon Germans for foreign exchange reach dangerous proportions. Germany as a whole is somewhat in the position of a bank which must be able to meet the calls of its depositors whatever they may be. It cannot rely upon new depositors to furnish money when old depositors are creating a run on the bank. Beyond a certain point, Germany cannot safely depend on renewals and new loans and credits to pay reparations and old loans and credits, for the payment of which it has no excess of exports available.

Germany has, of course, accumulated resources to meet calls upon the country for foreign exchange. Like a bank, it has reserves or cover for probable calls, and there is no critical situation as yet. But the reparation payments under the Dawes plan will increase considerably in the next two years. Even assuming that no other factor is affecting Germany's international credit, the increasing importance of this factor attracts attention and is naturally leading to more critical discussion of Germany's exchange position.

Will foreign exchange be available to make possible the transfer to the Allies of the increased amount which Germany pays in marks? Germany's reserves, though large, are limited.

The excess of exports is not yet apparent and no foreign country is helping to make it easy for Germany to increase her exports. Obviously, if we or someone else should lend enough money to Germany or Germans, exchange will be available, but whether such loans will be forthcoming is in the lap of the gods, who up to date seem most favorably inclined. I venture no predictions, particularly no pessimistic predictions.

The recent discussions about our advances to Germany have centered about one point in particular. What would happen to our non-governmental loans to Germany if they came into competition with Germany's reparation obligations? Suppose that at some time there should not be enough foreign exchange available, will the use of exchange to meet non-governmental obligations be restricted?

We have on this point to deal with the powers of the German Government, its obligations under the Treaty of Versailles and the Dawes plan, the powers of the Transfer Commission under the Dawes plan, and the powers of the Reparations Commission under the treaty and Dawes plan.

The Transfer Commission has power to make transfers, i. e., to purchase exchange, but only to such extent as in its judgment does not endanger Germany's currency stability. It cannot restrict the purchase or use of foreign exchange by Germans for other purposes. It can, of course, make suggestions to Germany herself and Germany is under a general obligation to cooperate in making reparation transfers possible.

Germany herself has sovereign power to place legal restrictions on exchange transactions. Such efforts are in the long run futile and even harmful and they are now quite out of fashion.

The Reparations Commission's present powers seem limited to the priority given to reparations by Article 248 of the Treaty of Versailles, which seems limited to the assets and revenues of the Reich and the constituent states. Even this is not strictly a prior lien, but what is technically known as a "floating charge", not applicable when there is no default, and there is in my judgment no likelihood of default, for Germany can certainly pay the marks to the Allies. The fact that reparation payments, after being made in marks, cannot be trans-

ferred is not a default. There are other features which seem to safeguard Germany's non-governmental obligations against the possible application of Article 248, but we need not go further.

This rough analysis of the legal possibilities shows no cause for alarm. But as a matter of fact it is hardly worth while to consider the legal technicalities. The fundamental safeguard in the situation is the obvious fact that it would be financial folly for any one to place obstacles in the way of providing exchange for the service of these non-governmental loans. Germany's credit is bound up with them. Any failure to meet them would destroy that credit. Reparation payments are dependent on Germany's credit. It took five years after the Armistice to drive this lesson home and make the Dawes plan a reality. It is inconceivable that any government should ever want to learn that lesson over again.

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AMERICAN INVESTMENTS IN SOUTH AMERICA

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Brown Brothers and Company, New York

THE subject of American investments in South America is so huge that the treatment of it must be defined and limited in advance. In order to bring this paper into manageable limits I am going to confine my discussion mainly to a consideration of these investments as they would naturally be viewed by an American banker, and by those to whom he gives investment advice. The complex, kaleidoscopic, colorful background of historical, political and racial problems interwoven with the economic problems, has got to be dealt with too, but only as a background. For comment on these background points, I still prefer to rely on Lord Bryce's book,¹ although it was written some fifteen years ago, and I shall occasionally refer to it.

American investment in Latin America (including Mexico, Central America and the islands of the Caribbean) is of two kinds: investment in corporate development as a proprietor, and investment in bonds as a creditor. These two types of investment occur in states or groups of states, where the United States appears to have four different kinds of relationship. Thus, in Mexico, we seem to be exceedingly unpopular, and the policy of our Government there may perhaps be characterized as baffled optimism, without any particular sense of direction. In Cuba, Porto Rico, Haiti, San Domingo, the Virgin Islands, Nicaragua and Panama, it seems to me that we exercise varying degrees of direct influence, ranging from a definite legalized status to a highly doubtful one. In this second group of states, however, I should say that our government had displayed courtesy and lofty motives, tempered at times by specific considerations focusing on the political and military aspects of the Panama Canal. A third group of states might well include those portions of Central America

¹ *South America: Observations and Impressions*, by James Bryce (New York, 1912).

where we have not exercised any of the attributes of suzerainty, but are feared and disliked because of our relations with the neighbors of these states. A fourth group comprises the states south of the Canal, where our own attitude is one of respect and friendship, but where we are nevertheless subjected to a good deal of suspicion and criticism, at least in certain quarters, because of our policies north of the Canal.

In this brief summary of our varying relationships with the group of countries that we call Latin America I cannot, for the purpose of this paper, attempt to be more specific. Perhaps this part of the subject may be summarized by saying that the group of countries in which we have made the vast investments hereinafter described, have shown a certain natural sensitiveness to our political and economic power, and that in general their affection for us seems to vary inversely as do their respective distances from us!

The amount of our investment in Latin America is very large, but is not capable of precise calculation. Standard sources of information vary considerably in their estimates. The Foreign Securities Committee of the Investment Bankers Association estimates the total advances to South America, covering both securities and short credits made by the United States during 1926, at \$508,000,000. I understand that this figure contains a total of \$324,000,000 for government, state and municipal loans, and of \$174,000,000 for advances to corporations. These figures do not include either Cuba or Central America.

According to the same authority, the total amount of foreign securities bought by the United States during the year ending June 30, 1927, was \$1,350,000,000 as compared with \$1,100,000,000 during the previous twelve months. Of the total flotations (although the fiscal years are not identical), South America seems to contribute at least forty per cent. By Dow, Jones and Company's calculation, our total foreign financing for the first nine months of 1927 amounted to \$1,315,000,000, divided between \$718,000,000 government loans and \$597,000,000 corporation offerings. Of this total of \$718,000,000 government loans, Latin American countries contributed \$269,000,000 and European countries contributed \$229,000,000. Of the total of \$597,000,000 corporation offer-

ings, Canada contributed \$358,000,000 whereas Latin America contributed only \$42,000,000.

There was another important figure in the Foreign Securities Committee report to the Investment Bankers Association this year. A comparison of the public issues of foreign securities by the four great capital-exporting countries in the year 1926 is set forth as follows (amounts all converted to American dollars) :

United States	\$1,134,000,000
England	560,000,000
Holland	116,000,000
Switzerland	78,000,000

The importance of these figures from the standpoint of the present discussion lies merely in the obvious inference that from now on, for as long a period ahead as we can see clearly, it is reasonably certain that the major part of whatever foreign financing is done by South America will have to be done in the United States market.

The Halsey Report to the Department of Commerce, issued in 1918 and brought up to 1924 with reference to Argentina, Uruguay and Paraguay, points out that before the war the interests of the United States in South America, other than in mines and the packing industry, were negligible. Great Britain has long been the largest investor in South America and the Halsey report estimates the total of her investments there, as of 1918, in excess of \$5,000,000,000. There are no exact figures available as to the extent of French investments, but these are taken as being in excess of \$1,500,000,000. German investments were also very large, but not specifically calculated in the report. Large as the current figures of United States investments are, therefore, it will obviously be a good many years before we arrive at a total investment as great as that already held by Great Britain.

With this partial statement of the problem, suppose we look first at what may be called the physical nature of this investment field and then perhaps in somewhat greater detail let us consider what may be called the administrative, or control machinery.

Lord Bryce says in his book, *South America* :

The most interesting of all the considerations which a journey to South America suggests are those which concern the growth of these young nations. What type of manhood will they develop? What place in the world will they ultimately hold? They need fear no attacks from the powers of the Northern Hemisphere and they have abundant resources within. Their future is in their own hands.

Lord Bryce reminds us further that there has been no war other than civil war in South America since 1883, when peace was made between Chile, Peru and Bolivia, and that most of the causes to which European wars have been due are absent from this continent. There are no religious differences, race questions or hostile minorities to deal with. There are, however, questions still unsettled relative to national boundaries, as we have been so recently reminded by the Tacna-Arica controversy.

It is characteristic of all these countries to have huge exports of raw materials, subject, like raw materials in general, to rather big swings from one year to another, and producing in general a favorable trade balance year by year, although there are exceptions to this. Merely to illustrate the magnitude of these figures, the exports from Argentina in 1925, calculated in American dollars, appear to have been about \$837,000,000; from Brazil, \$480,000,000 and from Chile, about \$228,000,000. Exceedingly large exports and large export balances are normally also furnished by Peru and by Colombia, although both in 1925 and in 1926 Colombia was slightly a debtor on balance.

An equally obvious tendency, of course, and a perfectly proper and natural one in rapidly growing countries with great areas, great production, small populations and new credit, has been a rapid and progressive increase in borrowings, and also in foreign capital invested as a proprietor in the South American fields.

It is not many years since the United States was in a similar position of a raw material producing country with inadequate development capital. Much more recently we added to our status as a great raw material country, a newer status as a great mercantile and manufacturing country, still with inadequate working capital; and we drew heavily on Europe, particularly on England, France and Holland, for

portions' of this working capital. Since the great upheaval of the war, we find a situation where, generally speaking, the amount of our capital available for immediate development work, both in the production of raw material and of manufactured articles, exceeds the current demand, and exceeds it by huge figures. A few thousand miles to the southward lies a great continent with a commercial and financial development which must be regarded as backward, but with immense potentialities as a producer of raw materials. Have we, then, in our financial relationships to Central and South America, a situation analogous to that which existed as between, for example, England and the United States during the generation after our civil war?

Were this analogy sound and accurate it would suggest the theoretical conclusion that the United States of America as a creditor country of great wealth would naturally be interested in the development of less developed states abounding in raw materials, where undoubted financial risks were present but were compensated, at least theoretically, by the prevailing rate of interest as compared to the rate of interest at home.

Like many other comparisons, however, the specific points of difference in these two situations seem to be quite as conspicuous as the points of resemblance, and the hardest test of all to apply is the finding of a simple and fundamental standard by which the goodness or badness of a particular loan can properly be judged, where the lenders are private individuals and the borrowers are to a considerable extent governments with the power to tax. Per capita debts as a standard, for example, are quite worthless, unless there is a similarity both in the character of the peoples compared and in the character of their trade and industry. Even where these elements are roughly comparable as, for example, in the respective cases of England and Germany, one can start with the very obvious fact that England has what looks like an extremely high per capita debt, while Germany since the war has an extremely low per capita debt, and yet English securities sell at a much higher market price than do German securities.

The little country of Norway, which has suffered greatly through a combination of circumstances arising out of the peculiar effect of the war on her trade and currency, plus the

very gruelling experience of restoring that currency towards a gold basis, with the severe trade depression consequent thereon, has an extremely high per capita debt and a not too satisfactory trade position. Yet the credit of Norway as measured in the market price of her foreign obligations is higher than the credit of France, Germany, Belgium, Italy, all of the succession states and the whole of South America.

In fact, should the statistician pick out one apparent anomaly from the figures before him, he might fairly aver that there seemed to be an inverse connection between very high per capita debt and good governmental credit. This curious statistical fact, suggesting as it does the inference that some states have a high per capita debt because they can borrow and that other states have a low per capita debt because they cannot borrow, might in turn point to the fundamental truth that credit seems to be a thing by itself, resting on other elements than statistics.

Moreover, per capita debt figures are particularly misleading in any country where there is a high proportion of uneducated, unprogressive and uncaptalist native population. It is hard for anyone living in North America, a country of capitalists large and small, to apply any statistical comparisons of any value whatever to countries where an exceedingly high proportion of the inhabitants do not save money, although the negro population of the cotton belt furnishes a certain comparison.

Another element which needs to be considered in connection with per capita debt, is the ownership of productive enterprises by the state. This is a conspicuous feature as affecting the figures in many European countries, for example, France, Germany, Norway and Italy, but state-owned enterprises again require in themselves careful analysis; sometimes the state administration is good; sometimes it is very bad.

Without burdening the point, the following brief comparison of certain per capita debts in various countries may be set forth merely to show that the figures sometimes are valueless, or nearly so, as a reflection of national credit. The per capita debt in Argentina seems to be about \$82 in American currency, of which somewhat more than one-half is internal debt. The per capita debt in Chile is about \$54, mostly ex-

ternal. The per capita debt of Brazil is about \$57, more than one-half internal. The per capita debt of Paraguay is about \$27, whereas the per capita debt of Uruguay is over \$150, but the credit of Uruguay is much better than the credit of Paraguay.

These figures, it should be said parenthetically, may be regarded as reasonably close approximations but not as being strictly accurate. In many cases the population has had to be approximated since the last census. In some cases the floating debts are accurately accounted and in other cases they are apparently omitted. In every country which has had long recourse to the world markets for capital there must also be taken into account external debts created by political subdivisions of the state, such as provinces, cities, etc., and an immense amount of research would be required to establish a figure in any country whatever which could be related to the general population figure as an index of total per capita debt.

It is sufficiently clear, however, that the question of credit risk does not rest on per capita debt in South America. Nor does it rest, to any controlling extent, on two other leading factors frequently stressed in bond circulars:—a favorable trade balance and a balanced budget. Trade balances can be quite good where credit is quite bad, and, conversely, a country can have a visible trade balance normally against it and definitely improve its position by further borrowings, if these borrowings are productive in purpose and not inflative in amount. Balanced budgets are, of course, desirable, if honest! But many solvent countries of relatively high credit were unable to balance their budgets by taxation during the years of reconstruction immediately after the war, and loans properly applied were a source of strength to them, not of weakness. A continued failure to balance budgets by taxation and other internal revenues is undoubtedly a danger signal; a temporary failure, occurring under unusual circumstances, need have no particular significance.

Past record on debt service is much more important than either of these things, and it should be said quite candidly that the past record of South American securities in world markets is, in general, bad. These countries have a very new

history as independent sovereign states and most of them have emerged from a bad political condition precedent. Most of them have had a good deal of fighting to attend to, and all of them were insufficiently supplied with working capital with reference to the nature of the work they had to do. In general, however, the experience in recent years has been good, and any analysis of credit risk must take into account three quite different periods: the financial history of South America from the middle of the last century until after the readjustments following the Baring failure—which was a bad history; the gradually improving conditions from the early 90's leading up to the present time, which on the whole furnishes a good picture; and then the various elements comprising the outlook for the future. Even in the days of difficulty, there have been some noteworthy exceptions to the rule. Chile claims proudly to be free of default on its external debt during a period of 100 years, and Lord Bryce points out that during the Chilean civil war in 1890 both President Balmaceda and his congressional antagonist, each claiming to be the lawful government, tendered to the foreign bond holders payment of the interest on the same public debt while the struggle was going on.

The report of the leading London authority is, of course, of much interest as bearing on the reviewed and summarized history of the past financial performance of South America on her loans. There was founded in London in 1868, under license from the Board of Trade, an association known as the Corporation of Foreign Bondholders, having as its principal object the protection of the interests of holders of foreign securities placed in Great Britain. The council of this corporation publishes an annual report containing a good deal of carefully collected data regarding countries and handling of debts in those countries where Great Britain has had trouble with its collections, and at the close of this report there is a comparison in tabular form of the principal loans in default. This table in the report for the year 1926, lists two defaults in Ecuador, four in Mexico, one in Argentina and ten in Brazil. The Argentina default, one of the Mexican defaults and all the Brazilian defaults occurred on provincial and municipal loans. Except for these listed defaults, it is note-

worthy that the only other important items in the default list of the council are the huge amounts set forth against Russia, a total of £1,700,000,000 plus some £744,000,000 interest in arrears, and the ancient defaults of eight of the United States: Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina and South Carolina.

It is worth taking a moment here to digress on this question of the defaulted debts of the American southern states, because there are certain analogies which have value in considering the problem of South America. The Council points out that the debts listed represent money borrowed for industrial undertakings and that they have nothing to do with debts incurred for war purposes. In the case of Mississippi, for example, the repudiated debt was contracted between 1831 and 1838 and payments in respect thereof ceased in 1841, some twenty years before the Civil War broke out. The money borrowed by Mississippi was applied to the establishment of two banks, but when these banks ceased to be remunerative investments the state promptly repudiated its obligations to the bondholders. The Council quotes the opinion of the Hon. Daniel Webster on this subject, in a letter which he wrote to Messrs. Baring Brothers in 1839, but points out regretfully that a year or two after Webster gave the Barings an opinion, which must in the light of subsequent events be deemed optimistic, Mississippi not only defaulted, but inserted a provision in the state constitution which specifically repudiated the debt!

Reference to this record of failure to perform a non-wartime obligation is pertinent, because there was undoubtedly an economic similarity between the position of these states and that of certain South American states, resting on the newness of their political and economic history, and on their exceptionally rapid development. I think it is quite clear on the records that the heat and fury of politics in the state of Mississippi far outweighed the broader aspects of state credit and general good faith at the time the famous repudiation clause was enacted into the state constitution.

It is perhaps fair to say that the general atmosphere of doubt which has surrounded certain foreign loans in the post-war period, and particularly certain South American loans,

has rested for the main part on natural misgivings whether in times of political turmoil the question of default on external borrowings could ever similarly become a campaign issue. There are two things about debts which tend to become chronic. One is a steady persistence in paying them, month by month and year by year; the other is a leaning towards the short and temporarily easy method of escape by default, and I think it has been made clear by the foregoing analysis that there are no very sure and obvious statistical checks which indicate whether or not default is likely to occur in the case of national or state debts resting on the taxing power. If economic possibility is present, the controlling point is the will to pay, and the will to endure very real taxation hardships for the sake of keeping good a credit, which, if it is kept good, will in time make the burdens easier to bear.

In connection with the English market for South American securities we come naturally to a consideration which is rather foreign to our practice and experience, but which has always been regarded as a characteristic accompanying the foreign investments of England and also of Germany. I refer to the rather complex subject of controls and priorities, both as between borrowers and lenders and as between governments.

In the English market, which did so large a proportion of this type of lending in the years before the war, the reciprocal controls were rather good. The thing was not very clearly set forth, and, like many other good English institutions, had the looks of a muddle, but worked very efficiently in practice. There were only a few houses which could qualify as issuers of the first rank or even of the second rank; their liaison with the Bank of England was close, and supplementing all this there was the traditional dislike of encroachment, which effectively prevented two or three houses from finding themselves in a bidding match, to the great temporary advantage of the borrower but to the disadvantage of the lender and his customers.

We have none of these controls. Our issuing houses are exceedingly numerous, and through group associations in themselves fluid and kaleidoscopic, a number of relatively small houses can join forces and bid on nearly any attractive piece of business. There is little or no feeling against en-

croachment on a house's privileges in the foreign field, for the good reason that no American house has had long enough contacts in any of the European or important South American fields so that it really has any very important standing as against another house. Quite a different situation is presented in the natural banking lines which have been built up inside the United States, as between bankers and their corporate clients. These lines tend to become exclusive by force of habit rather than by actual exercise of majority ownership, and I have no doubt that in general the orderly continuance of established contacts looks to the good of both parties to the bargain.

We must recognize, however, that in the foreign field this situation does not exist except to a limited extent. As a result there is a real danger that the exigencies of invited competition and the desire of certain houses to obtain a foothold in foreign countries while conditions are yet malleable will result (indeed it undoubtedly has resulted) both in making loans that ought not to be made and in paying too high a price for the loans that are made.

We have all of us been in such a fairy dream of prosperity and of the pressure of capital funds on the relatively limited supply of securities available as a medium of investment, not only during the last year or so but more or less continuously since 1922, that I think there is a particular danger of confusion of thought along these lines. There is no doubt that South America offers a rich and proper field for the investment of American capital, if this investment is hedged with due precautions, and if careful consideration is given by the issuing bankers to the broader aspects of the problem with which they are dealing.

But if loans are going to be made indiscriminately simply because South America wants the money and we can not get as high a rate of interest elsewhere, and if irresponsible competition is going to find expression in bids which reflect temporary market conditions rather than the underlying essentials of the situation, I think there is cause for a good deal of apprehension. I am exceedingly glad that the Academy is discussing this, because the discussion is taking place during a period of the most brilliant and protracted financial sunshine.

There is hardly a cloud in the South American sky from the standpoint of the American lender, and I am not implying that South America, or any individual country in South America, has as yet had too much money from us. I think it is fair to say, however, that if we were to continue making loans at the present rate for five or ten years more, we would give, at least to certain states in South America, too much money. How much that rapidly growing part of the world ought to have each year, neither I nor anybody else knows, but perhaps the simplest way to state the case is the negative way; that is to say, South America ought not to receive so large an amount that the result is inflation, general or local, accompanied by rising and burdensome taxes and followed by the type of monetary crisis which, in past years, has proved to be particularly acute in the Latin American countries.

The other unsettled problem of great importance to the consideration of this whole subject of controls, is just what the relationship of American Government policy, if any, is to South American loans. There have been a number of widely differing schools of thought on this point in America. There has undoubtedly been a feeling in certain quarters that the English Government, at least in past times, has been disposed to cooperate more or less actively with private interests in following up the investment of British capital overseas and of furthering the interests of the investor so far as possible in cases of difficulty. There has been a similar opinion, freely expressed at times, that the American Government has been somewhat given to changes of policy back and forth in this respect, but that traditionally and over the years it did not show any very evident interest either in our trade position or in our financial position in foreign countries. This point has particular bearings on our relationships with South America, and I think we should recognize frankly that in many quarters the rapid extension of our financing and development work in these countries has led to certain feelings of jealousy and suspicion as to our motives. Particularly in Mexico and in Central America, our government policy, as previously stated, has oscillated between the coercive and the negligent, and there is a strong body of American public opinion which greatly dreads the kind of diplomatic entanglements that

might arise out of any definite policy of our government exercised towards American interests south of the border. I am inclined to think that the newer American practice of making loans freely in South America without any feeling of reliance on our government in case of possible future difficulties has certain marked advantages in the promotion of harmony between the United States and this group of countries south of us.

So far in these comments I have not attempted to treat separately the very different problems arising, on the one hand, from a loan policy to various governments having the taxing power and on the other hand the question of purely commercial investments in the industries of the country.

Apart from the enormous American investment in the sugar and the tobacco industries of Cuba; an investment which, taking into account affiliated industries, such as banks and railroads resting on these two basic industries, was estimated by the Department of Commerce in 1924 at \$1,300,000,000, we have a comprehensive estimate from the Department of Commerce placing our investment in the rest of Latin America at about \$3,500,000,000. This includes probably nearly \$1,400,000,000 in Mexico, and it includes in addition to the purchase of government bonds the extremely important oil investments in Mexico, Colombia and Venezuela; the plantation investments in Colombia, Costa Rica, Nicaragua, Honduras, etc.; the cattle and grain farming investments in Argentina and Uruguay; copper investments in Chile and Peru, etc. Professor Collings estimates¹ that our investment in Colombia alone is about \$88,000,000 and that it is \$100,000,000 in Peru; the two latter named countries until very recent years having been quite unknown in the American security markets. Professor Collings says:

It can safely be said that our Government has had no clearly defined foreign investment policy. As a borrowing rather than a lending nation we had no need for it. But we have now become a powerful financial unit in the comity of nations. . . . American foreign investments constitute today our widest departure from the policy of isolation. In no part of the world have we larger or more important investments than in Latin America. Here we lay the cornerstone of our policy. To date, that policy seems to tend toward constructive enterprise rather than exploitation in the foreign field, and toward supervision to prevent injustice to either borrower or lender.

¹ *Current History* (September, 1927).

For the purposes of the present discussion I would be ready to assume as a definition of what appears to be our foreign policy south of the Panama Canal, that it is not unfriendly to the placing of American capital in these states, but that the American lender must not expect his government to exercise coercion in his private behalf.

Accepting this as a basis, I should say that, with access to the great natural resources in these countries; with shrewd and capable administration and freedom from political disturbances, it would seem quite obvious that the whole Latin-American field, from the standpoint of industrial development and profitable return on invested capital, was one of great promise. But, unfortunately, there has not always been freedom from political complications. Sometimes these industrial developments by northern capital have undoubtedly tended directly towards the political disturbances which ensued. But I see no useful object in attempting to generalize or to formulate any workable conclusions on this phase of the subject. With the exception of Mexico, I think it may be said that American industrial investments in Central and South America have worked out well, on the whole. There have been fairly large risks, which have been compensated by fairly large profits, and the net result of this development in many of these countries has undoubtedly been an important accession of developed national wealth and improved standards of living.

Short of interference by extreme governmental policies either north or south, a strong industrial company, ably managed, ought to be able to find its own way through changing local conditions as they present themselves, and this in general has clearly been the American experience, with no major checks to date outside of Mexico.

The loan policy to governments having the taxing power, as distinct from the investment policy on the earnings of industry, presents an entirely different set of problems, and it is these problems, I think, with which we are most concerned at the moment. I should say that the final test of the goodness of loans to South America went even beyond the question of stability of government, although this is perhaps the point which has raised the most pertinent questions in this market and has received the greatest amount of attention. More im-

portant even than governmental stability, I must reiterate, is a traditional will to pay, so strong that it becomes a national trait capable of surviving even severe shocks arising out of changing systems of governmental administration. Take as an example Chile, with its unbroken record of continuous payments on its foreign debts. This very fact, it seems to me, introduces a factor of safety in Chilean loans which is relatively more important than a trade situation such as the present one in Chile, where the development of synthetic nitrates has to some extent threatened the fundamental industry of the country. I am not implying that the Chilean export trade difficulties are incapable of solution, but as an investor I would prefer this undoubted hazard to the hazard of investing in a country rich in natural resources but untried, or with a bad past record, in the matter of this fundamental, established will to pay its obligations throughout all contingencies, good or bad.

Another type of difficulty not easy to control and very alarming wherever it is manifested has occurred at rather too frequent intervals throughout the history of South American borrowing. I refer to so lax a loan administration that money raised for one purpose is used for another, or is merely wasted, so that the loan instead of adding to producing power merely becomes a burden and sometimes an impossible burden on the finances of the country. The particularly scandalous classic instance of this sort of thing arose some years ago in Honduras in connection with the efforts to build an inter-oceanic railway from Puerto Cortes, on the Caribbean, to Amapala Bay, on the Pacific Coast. This affair was a long scandal which started prior to our Civil War. Up to 1873, fifty-seven miles of this line had been completed, at a cost estimated at \$1,500,000, against which cost a debt of £5,990,000 had been contracted. Mr. Halsey's report to the Department of Commerce makes the naïve comment that the total with interest accrued to January, 1917, amounts to approximately £26,000,000—this for building fifty-seven miles of railroad!

There have been more recent, although less scandalous, cases of the misuse or careless use of loaned funds in South American states, and I think that moral and contractual re-

sponsibility on the part of the borrower to use the loaned funds as he says he is going to use them, and in no other way, ought to be one of the major considerations affecting our loan policy in this part of the world.

There is one other tendency in South American financing to which attention ought to be directed. The commercial and industrial development of these countries has been fostered to such an extent by great proprietary ownerships of natural resources held and administered by Americans, Englishmen, Frenchmen and Germans, that to a rather unusual extent the final profit from these enterprises has tended to flow out of the country rather than to remain in it. This is a generalization and is subject to many exceptions in detail. It indicates to me, however, that what would be regarded, say in a European country, as a normal relationship between the growth of foreign state debt and the growth of commercial resources is not necessarily quite a safe relationship in South America where the growth both of industry and of State debt has been very marked, but where much of the profit of industry has gone abroad. I do not think this point needs to be overstressed, but I merely mention it in passing.

In conclusion then, with regard to the present unprecedented flow of American funds into South America, I am inclined to think that certain difficulties will arise from plain, old-fashioned over-borrowing in an easy money market. I do not imply, however, that this experience will be general, and I have no doubt that there will be a marked credit separation, over the years, between certain countries which will develop an ability to control their borrowings and to recognize the vital importance of unbroken credit, versus certain other countries where the will to pay may perhaps be less conspicuous than the will to borrow. But an investor who gets a 7 per cent return in a 5 per cent money market must in any case realize that a portion of the yield on his bonds represents interest on his money and the balance is a reward for taking certain risks, not necessarily unjustifiable, which are inherent in the nature of the enterprise.

GOVERNMENTAL SUPERVISION OF FOREIGN LOANS

CARTER GLASS

U. S. Senator from Virginia; Ex-Secretary of the Treasury

THE rapid growth in the United States of capital available for foreign investment, and the increased demand in the American money market for loans in foreign countries to finance their governments or their industries, would seem to call for a careful re-examination and scrutiny of our governmental policy with respect to the supervision or control of foreign loans.

Origin of Existing Practice of the U. S. Department of State

The present practice of the State Department is of recent origin. It dates from the early days of the Harding Administration, or to be more exact, from the year 1922, when it was supposed to have been inaugurated not as a war measure or even to meet a post-war emergency, but to aid the Government in its negotiations for settlement, adjustment or funding of its war loans.

The action of the State Department nearly three years ago in closing the American money market to France, Italy and Belgium until those countries agreed to effect the settlement of their war-time indebtedness to the United States, aroused much comment. When Belgium and Italy came to terms and agreements were ratified by the legislative branches of their governments, the ban was virtually raised in connection with those countries, while the Mellon-Berenger agreement was negotiated with France but not ratified by the French parliament. The ban still remains with respect to France, although recently the State Department, apparently to facilitate negotiations which were at an acute point over the new French tariff schedules, suddenly notified the French Government that it would agree to the flotation of a French refunding loan which would simply replace, at lower interest rate, French bonds now in the hands of American investors. The extent to which our government has gone in the exercise of its influence without any sanction

of law is well illustrated by the recent announcement that the Department of State had approved the proposed refunding by France of \$78,000,000 of eight per cent bonds which private bankers marketed in the United States for the French Government and also the formal official announcement that the State Department has approved a Prussian and Polish loan totaling \$100,000,000. No such power was previously exercised by any department of the government even during the period of the war emergency or the post-war emergency. Often things are done during a war which should not be done in times of peace and if any such measure seemed necessary or advisable it would seem that it belonged rather to the Treasury Department than to the Department of State to take the initiative, because to the Treasury Department matters of a financial nature are properly confided. In a post-war exigency when the Treasury was grappling with the Victory Loan and later in the different initial stages of its certificate policy, some eastern bankers asked the Treasury if certain contemplated flotations of foreign securities in this country would impede Treasury operations. When told that they might, these bankers did not pursue the matter, but the Treasury, even in the exigent circumstances cited, assumed no authority to visé private loans or to veto them and engaged in no official correspondence with foreign governments on the subject. It simply responded frankly to an inquiry which bankers were not obliged to make and gave an answer which they were not obliged to regard.

It was so when the United States Chamber of Commerce queried the Treasury in the post-war period about a proposed international conference in this country which the Treasury was sure would result in a discussion of the foreign debts and consequent embarrassment to the Treasury; but the Treasury assumed no right to prohibit such conferences nor did it make it a practice or adopt a policy of approving or disapproving.

It might have done so with vastly more propriety than the Department of State, which has no conceivable relation to matters of private, domestic, or foreign finances, whereas the Treasury was established to deal with both and does so under sanction of law expressed and implied.

But not even the Treasury, much less the Department of State, is charged by law or custom with authority to control

the private loans of American bankers to foreign governments in time of peace or private enterprises in the ordinary course of business. I could easily comprehend even now, when the Treasury is engaged in extensive refunding of operations of its own, how bankers might with propriety ask if their activities in foreign securities tended to embarrass the Treasury; but I am not aware that the Department of State is authorized to engage in international or domestic financial operations.

Existing Practice Illusory, Illegal and Unsound

The State Department has no more right to establish a practice or adopt a policy of approving or disapproving of foreign loans to private individuals, concerns or corporations in the United States than it has to embargo the export commodity trade of this country. It has no more right to prohibit the sale of American credits abroad by the National City Bank, the Chemical Bank, or the House of Morgan, or all of these combined, than it has to favor or veto the sale to the European trade of the products of General Motors, the United States Steel Corporation, Henry Ford or other private concerns in this country.

It is admitted by the State Department that no legal warrant exists for its sanction or disapproval of private loans to foreign countries; but, on the other hand, virtually all of the loans made abroad since March, 1922, have been reviewed by the State Department, the bankers, at the suggestion of the Department, voluntarily submitting their proposals to the Department in advance. In many cases this custom arose because the bankers did not desire to embarrass the government while the delicate negotiations of adjusting the foreign debts were in progress.

A statement was recently attributed to the President that some policy of this sort was rendered necessary through a dread that Congress might, by legislative enactment, inaugurate a system of control out of agreement with the judgment of the executive branch of the government; furthermore that a justification of the exercise of such prerogatives by the State Department with the approval of the executive might be found in the right of the executive, through his State Department, to manage without restraint or constraint of law the foreign relations of the government. It seems incredible that the

President, who is so in the habit of thinking clearly and of applying his fine common sense to public problems, made any such statement or holds any such views. Certainly the constitution confers on Congress, and not on the executive, in terms, the exclusive power "to regulate commerce with foreign nations". It is certainly the first time in the history of the country that the theory is propounded that "foreign relations" embraces the private business transactions of American money lenders. My thought has been that a completely comprehensive definition of the term would restrict it to the relations of the United States as a nation to the governments of foreign nations, as established by treaty and prescribed by what the world calls international law. Never before have I heard it suggested that the private business transactions of individual tradesmen or the sale of credits abroad by American bankers constituted an item in this nation's foreign relations. Hence the action of the Department of State in assuming the establishment of a policy of approving or vetoing private loans to foreign governments is incontestably extraconstitutional and without sanction of law. Such a practice is not warranted by a sentence of the constitution, implicit or otherwise, nor by any law of Congress.

It is, furthermore, an illusory and deceptive practice. Upon what hypothesis of sound economics does such an appropriation and exercise of power, not granted by any law of Congress, proceed? What facilities, as a practical fact, has the Department of State to determine accurately any of the intricate details involved in matters of such magnitude; and by what authority are such facilities, if they exist, provided, and at what cost? In short, who is the trained international banker, with his retinue of aides, the experienced, the tested credit man of the federal Department of State, who presumes to pass on the investment requirements of this country and to say which of the foreign nations are entitled to credit in America and upon what terms?

I should be interested to learn to whom this financial expert—for essentially he must be an expert—is responsible for the unauthorized counsel he gives. Likewise, whether his advice is always impartial or ever sinister. It may easily be conceived that there will be times, if these extraordinary financial pro-

cesses of the Department of State are to continue, when an American banking group will be vitally interested to know precisely why its credits were rejected, while the transactions of a rival group were favored. Indeed, it might easily occur that a foreign government to which American bankers were willing to make loans would marvel and feel aggrieved that the federal Department of State had put an embargo on its bonds while officially attesting the high credit of another nation.

Since there is no authority for the examination and review of a proceeding of this kind, unauthorized by law, it would be interesting to know who is to determine whether the power thus irregularly exercised was used wisely or improvidently, fairly or capriciously, with intent to subserve the public interest or with purpose to enrich some and punish others.

Except for the unquestioned integrity and approved patriotism of the incumbent Secretary of State, who may say exactly that the exercise of this unprecedented power, totally at variance with any proper function of the Department of State, will not some day be so flagrantly prostituted as to result in a distressing scandal? Such extraordinary power, incongruous and in every way inappropriate, is not essential for the achievement of any good purpose, but might too readily be employed in illicit and dishonest pursuits. As an expedient of partisan political advantage, it might be used in a way to involve scandal at home and ill-feeling abroad. I am not making the thoughtless mistake of arguing against an essential power merely because it might be abused; but I am protesting against an unwarranted exercise of a dangerous, unessential power, replete with temptation, and even invitation to dishonesty and oppression.

The exercise of such power at best and in the cleanest way would inevitably draw the government of this country into sanctions and moral obligations which would be, as they already have been, misleading and injurious. I say again, what business has the government at Washington to be approving private financial transactions in which the government has no stake and properly should have no concern?

Neither has it any business to be vetoing such loans and thus assuming, without sanction of law, to embargo the sale of American credits abroad. Private business has no right to ask

or to receive the imprimatur of the government on its credit transactions, nor should foreign governments be required to get the permission of our State Department to engage in the ordinary commerce of credits or commodities with American business concerns.

Such concerns should be left to conduct their business on their own responsibility and at their own risk, and purchasers in this country of foreign securities taken by American bankers should not be persuaded to suppose that a foreign bond issue approved by our Department of State is necessarily a secure investment or that an issue not sanctioned at Washington is to be shunned as unsafe.

Bankers' Position With Respect to Supervision

It is often said that bankers have expressed their willingness to have the government approve these loans. Much as I like and trust the banking community, I hope nobody imagines that I have remonstrated against this irregular exercise of an unauthorized power in Washington because of any concern for these international bankers. They manage to take care of themselves. *My protest is against another dangerous centralization of power in the federal government*, and particularly against usurpation of a power with which the executive government is not legally clothed, and which, exercised without responsibility or subjection to review, may easily be frightfully prostituted in various ways.

Of course, the group of bankers referred to is not only willing but eager to have the federal government approve its loans. Such approval constitutes them the favored *protégés* of the government and renders them grateful beneficiaries of favors bestowed, as well as expectant recipients of benefactions to come. Acquisitiveness is the secret of their rejoicing.

I notice in this very connection that this obedient group of bankers in New York boasted that \$140,000,000 of these approved foreign bonds had been placed in the money market recently in one week. If this is an actual fact, what does it signify except that this considerable fraction of an immense total of foreign securities, at abnormally high interest rates, having the persuasive prestige of United States Government approval, is thrust directly in open market competition with

American note and bond issues, which have not the advantage of their government's imprimatur to stimulate their sales? That is one of many grave objections to this unauthorized and discriminating use of the Government's credit; for that, in effect, is what it amounts to.

Every railroad, every public utility of any kind in this country, every productive enterprise in America, every domestic business project requiring large capital and unable to pay ruinous interest rates, and, indeed, the United States Government itself in its certificate sales and lower-rate refunding operations, are made victims of these government-blessed foreign securities, which Washington thus approves, confessedly without knowing one earthly thing about their real value or security.

Dangerous Centralization of Power Should be Abandoned

There has been recently a lot of talk by public men and comment by the press over the alarming concentration of power in the Federal Government at Washington. Most of the talk, as well as the comment, has been general, except when politicians and newspapers have persisted in discussing the excesses and delinquencies of federal prohibition. This all seems trivial to me in contrast with other things that have happened and constantly are recurring, which, singularly enough, seem to have attracted little attention and provoked less intelligent criticism. They involve, some of them, not only the liberty and property rights of the individual and the sovereignty of the states, but a plain usurpation of authority by the Federal Government, which is as injurious as usurpations of authority usually are and, besides, exceedingly dangerous. The fact is, we have embarked—fortunately without the sanction of law—upon a policy that is deceptive and dangerous, for which, in my judgment, the petty advantages of temporary political expediency in negotiations with foreign governments afford no adequate excuse. This policy, in my judgment, ought not and will not receive the sanction of law; and it should be abandoned absolutely by the State Department at the earliest opportunity when it is next called upon to express its opinion upon proposed private loans to foreign investors, whether they be foreign governments, foreign industries or individuals.

FOREIGN INVESTMENT PROBLEMS

HERBERT FEIS

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BEFORE discussing the particular aspect of the problem of foreign investment to which I want to call attention I should like to address myself very briefly to one or two points in the papers of the previous speakers on this program.

First of all I have been moved by Mr. O. K. Davis' impassioned plea not to be afraid of straw men, and I am therefore led to say a word about that straw man who says that many economists make the habitual assumption that foreign borrowers are asked to pay more for American goods than for the same goods bought abroad. I think the position of the American economists and the remarks that have had that tendency, have come from the fact that these economists were studying the same figures that Mr. Davis presented and they saw the steady, persistent growth of foreign purchases of American goods. They therefore came to the conclusion that there was a disposition to purchase American goods when there was a judgment that the best value could be received from such purchases and that if and when they didn't use the proceeds of loans to buy American goods, it was because more favorable terms were offered by the producers of other countries. That has been the basis of their assertion that on the whole the tying-in clause would prove to be unfair to the borrowers.

The second matter I would like to touch on equally briefly is the use of a term by Mr. Ray Morris in his paper. The term "control" was applied to the arrangement under which one banker tended to have the duty and care and right of handling of all the finances, all the foreign borrowing of a foreign state. I think undoubtedly there is something to be said for that situation, but I hesitate to apply the term "control" to it. Reviewing some of past international lending history, I think you will be struck by the fact that some of the worst defaults took place when arrangements existed by which all

of the foreign borrowing was handled by one great banking house; for example, the Argentine default when practically all the Argentine borrowing was handled by Baring Brothers, and the Russian default when practically all the Russian borrowing in the market of France, the chief creditor country of Russia, was handled through the *Credit Lyonnais*. I trace that to the fact that these institutions became more and more involved in the credit situation of the borrowing countries and therefore had to make further borrowings against their free will and their own better judgment.

It has seemed to me that the best use I could make of the brief space allotted me in this discussion would be to attempt to supplement Mr. Swan's analysis of the world's present and future demands for capital by certain comparisons between the rate of American foreign investment during the past few years, and the rate of investment of the chief creditor countries of the world before the war. Such comparison, I hope, will aid us to form a clearer judgment regarding our own recent activity as a lending country, and enable us to measure the importance of our foreign lending in our general economic life. The statistical material available for such comparisons as I propose to make is unfortunately inadequate and of uncertain accuracy. For every item which it is necessary to measure, various methods of computation may be and have been used; besides, the nature of the original data is often unsatisfactory and incomplete. As a matter of fact, in working through the available material I was often reminded of the story told by a Scotch evangelist by the name of John O'Neal, who had once been a railroad porter. He had been invited to address the General Assembly of the Presbyterian Church in Toronto. He came and the proceedings were opened up in the morning much as these proceedings have been opened, and John O'Neal sat on the platform much as I have sat and listened to the series of addresses before him, and they were all statistical. The officers of the Presbyterian Church there made reports explaining the financial situation of the institution, how much had been contributed, how many new churches had been built, how many regular members of the church there were, how many communicants, how much had been spent for mission work, how many converts, and so on and so.

ship; by 1913, in fact, this had risen to over nine per cent. France, during substantially the same period, was applying over five per cent of her annual income to the same purposes, while Germany was using only about one per cent of her annual income. It will be seen, therefore, that great as the rate of growth of our foreign investment is, and revolutionizing as it will be for our economic and political life, it takes but a much smaller part of our national income than English and French foreign investment did before the war. This is to be expected in the light of our huge domestic economic development and the rapid growth of our national income during recent years.

It is, perhaps, even more interesting to attempt to measure the portions of annual savings represented by the growth in foreign ownership, as an indication of its importance in the whole of our economic life. Expert guesses as to the annual volume of American saving for the three years 1923-25 place that saving between ten and twelve billions of dollars, the latter being probably nearer the fact. It seems indicated, therefore, that the growth of foreign ownership by Americans represents about ten per cent of our annual savings. Bowley, Stamp, and Pigou have all made estimates of British saving for the year 1911 of about \$1,600,000,000. Therefore, it may be deduced that in the years before the war Great Britain was investing abroad in the neighborhood of fifty per cent of all her annual savings. Not possessing extensive domains such as our own, Great Britain's capital rushed to the rest of the world. Similar computations for France show that before the war, thirty-five to forty per cent of her annual savings was being invested abroad, the larger part seeking a return, however, not from industrial investments, but from government loans. Figures given by Helferich for Germany show that only five per cent of her annual savings were going abroad, a smaller proportion even than our own. This can be understood in the light of the well-known fact that Germany's industrial development was constantly running ahead of her available capital accumulation.

One last measurement. How important an item, comparatively, is the income received from our foreign investment in our total income? Official estimates, combined with the fig-

ures already given, show it to be less than one per cent of our total income, but growing rapidly in amount. Assuming a constant rate of growth in our foreign holdings, it will result that the sum of income received from this source will equal new foreign investment by about 1930. Computations from Great Britain indicate that during the years 1907-13 about nine per cent of her total income was being derived from foreign ownership; and this country appears to have reached the stage whereat the income from abroad roughly covered the rapidly growing volume of new investments. France was receiving during the same period about six per cent of her total income from ownership abroad; and this income from ownership abroad certainly covered her new foreign investment. Germany's income from ownership abroad was at most $2\frac{1}{2}$ per cent of her total income; and steadily tending to fall in importance.

It is impossible for me, in the time at my disposal, to attempt to interpret the significance of these figures, but I think that consideration of them may help us to understand and to guide properly the extension of American investment throughout the world.

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THE AMERICAN BALANCE OF INTERNATIONAL PAYMENTS

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THE question to which I wish to draw attention very briefly is simply the nature of the changes which have taken place in the American balance of international payments since the war, and the conclusions which we can draw as to probable future developments.

Of the various items that enter the American balance of international payments, there are two that have been of predominant importance: the commodity balance of trade, and the net export or import of capital on account of principal. These two items have not only been the largest in the aggregate, but have also been the ones that have fluctuated most widely and most significantly.

The other items in the American balance of payments have been relatively stable. They have grown, but the growth has been a fairly steady increase each year, without marked fluctuations or reversals of trend. This is true, for example, of the aggregated net interest and profits and dividends item: we have had a moderate but steadily growing international credit on this account. It is also true of tourists' expenditures, of immigrants' remittances, of freight charges, and so on. The aggregated total of these so-called invisible items shows a steadily increasing net debit in the international account. Even the movements of gold, which are only a small item in the general aggregate, have shown a fairly steady trend since 1921; that is, a diminishing net debit that has recently passed zero, and has begun to show a small net credit. These smaller items, to repeat, are stable, are growing fairly steadily in one direction or the other, do not fluctuate widely, and for at least certain of our purposes are therefore not especially significant.

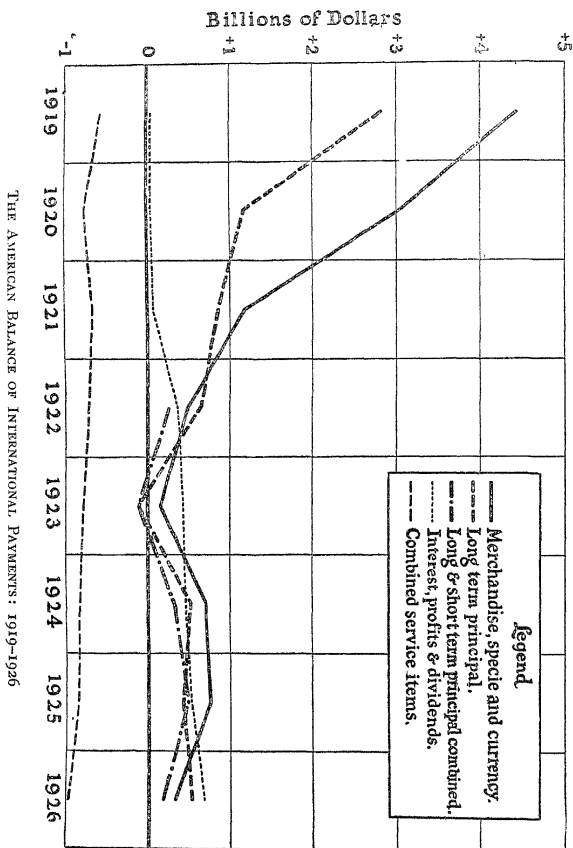
But the movements of the commodity balance of trade, and the movements of capital on account of principal, have fluctuated widely and irregularly. In 1919 we had a very large

favorable balance of trade. This balance then fell steadily, until in 1923 it was very small indeed. It rose again in 1924, but since then has again been falling, although quite gradually. Similarly the net export of capital on principal account was phenomenally large in 1919. It then fell rapidly, and became a net *import* in 1923; it rose again in the following two years, and finally in 1926, the last full year for which we have data, was again declining.

The striking thing, however, is that the fluctuations in these two items have gone remarkably closely together, especially since 1921. The closeness of that relationship is indicated by the accompanying chart. The upper curve, the solid line, is the commodity balance of trade. The heavy dash line immediately below it is the net movement of capital on account of long-term principal, while the heavy dot-and-dash line from 1922 through 1926 is the same curve with the net movements of short term and demand balances added. The curve for the trade balance and the two capital curves not only fluctuate very widely; on the whole, and especially since 1921, they can also be said to fluctuate quite closely together. The dotted line is the interest, dividends and profits item, showing a quite steady net increase in our credits. The last and lower dash line is the non-capital invisible items curve, covering the various service transactions. It shows a slowly increasing, fairly large net debit.

I shall not attempt to explain the closeness of the relationship between the balance of trade fluctuations and the fluctuations of the capital movement. There may be, as one speaker has already suggested, a cause and effect relationship between the two; that is, changes in one of the two items may produce similar and offsetting changes in the other item. More probably I think that in this case both sets of changes are the product of a common antecedent cause, namely, the war-time and post-war upheavals in Europe; but neither this nor any other similar conclusion can be submitted to positive proof, and I shall not go into the question farther here.

Let us turn, instead, to the question of what light these figures cast—if they cast any at all—on the probable future development of the items in the American balance of payments. Of course we cannot foresee that future development with any-



THE AMERICAN BALANCE OF INTERNATIONAL PAYMENTS: 1919-1926

thing approaching accuracy, but in at least several directions we can make a fair estimate. Take, for example, the international movement of investment capital: we can make at least a plausible guess as to what will happen to that item in the next few years. I see no reason for thinking that new foreign investment by Americans is going to undergo any sudden and permanent decrease in the near future. It is true that a business depression in this country, or a sudden growth of prosperity in Europe, would produce a decline for the time being; but I think that such a decline would be only temporary. Our gross new foreign investment is apt to hold at least for some years at about its present level, something slightly in excess of a billion dollars a year. During the last five years we have made a place for ourselves as one of the great investing nations, and I do not think that we shall relinquish that place, if at all, for many years to come. But against this annual new investment by Americans, various other items must be set. Foreigners are now buying back their own securities; they are paying off some of their own loans; they are even buying our own American securities. All those transactions go in on the other side. In addition there are, of course, the slowly growing interallied debt payments. These various items—which represent the import of capital into the United States, instead of the export of capital—already almost equal and offset our annual new investment, and there is every reason for thinking that they will grow. On balance, therefore, I think that from now on we shall import as much or more capital on all accounts as we export; that is, we shall have a small, slowly increasing net credit in the aggregate annual capital account. Although we shall be one of the world's great foreign investors, paradoxically, we shall nevertheless be a *net* importer of capital on a small scale.

Similarly, interest and dividends on our foreign investments will grow steadily, but against this are the interest and dividends we must pay to foreigners on their growing investments here, as we used to do on so large a scale before the war. On balance, I think that we shall have a large credit on account of interest and dividends, but one that does not grow very rapidly.

Then there are the other invisible items: tourists' expendi-

tures and immigrants' remittances and freight charges, and so on. These items, taken together, have shown a quite large and slowly increasing net debit ever since the war. There is no reason for thinking that this trend will be greatly altered in the immediate future.

There remains, finally, the commodity balance of trade. The balance of trade serves, in the long run, as the compensator in international payments, the residual element, the element that takes up the slack and offsets everything else. It does not always fulfill that function in any immediate quick-operating way, but in the long run that is substantially the rôle it plays. In our case, it will operate to restore international payments to equilibrium after the suggested changes in the other items have come about. If we now bring these estimated probable changes together, they indicate that apart from the balance of trade we shall have, in future years, a small but growing excess of net credits in the international account. These credits we can receive only in the form of commodities. In other words, we may soon look forward to a small but growing excess in commodity imports over exports before very long; that is, to the popularly dreaded unfavorable balance of trade. That unfavorable balance may arrive next year; it may not arrive for five or ten years; we can't tell, but I think it is quite surely coming nearer every day. I would not be unwilling to subscribe to the date already suggested, 1929 or 1930, as about the time that the change in balance of trade will take place.

But we shall acquire this unfavorable balance simply by increasing our imports, which are largely imports of raw materials. I don't see any particular reason for expecting any substantial decrease in our exports; there may be some decrease, but I don't think it will be a large one or a permanent one. Nor do I see any reason for expecting any diminution in our prosperity. Rather, we shall have higher prices than we would have had without this unfavorable balance of trade, and greater prosperity. The prospects for our near future seem to me very pleasing.

FOREIGN INVESTMENT AND PUBLIC POLICY

LEWIS S. GANNETT

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I SUPPOSE I was asked to take part in this discussion in the hope that I would pick a fight to start the discussion of the interesting papers on foreign investment problems to which we have just listened, but it is very difficult to do so. Like Mr. Feis, I was particularly impressed by Mr. O. K. Davis's demolition of straw men. As I listened to Mr. Davis passionately proclaiming the ability of American manufacturers to compete on equal terms with the manufacturers of foreign nations, I almost expected to hear the Secretary of the National Foreign Trade Council proclaim himself a free-trader and assert that American manufacturers could compete with foreign manufacturers at home as well as abroad, without the artificial aid of a tariff. Having sometimes had occasion to criticize American bankers for their dependence on governmental protection of their investments abroad, Mr. Ray Morris's exceedingly long-visioned recognition of the social factors involved in foreign investments left me almost without ammunition. Yet there may still be bankers who do not entirely agree with Mr. Morris, and if I cannot attack him, I may still perhaps point to some of the dangers and difficulties inherent in the situation, which have displayed themselves in the past, and may again in the future.

You remember F. Oppen's cartoon, which Mark Sullivan has revived in *Our Times*, with a little figure of Mr. Private Citizen, a very small figure in the presence of the large bankers and industrialists, with a very small head and very large ears, trying very hard to emit a large voice of protest. I intend to speak in his behalf.

There are certain dangers even to these very small private citizens in the enormous expansion of American foreign trade and foreign investment. Even those of us who do not participate in the expanding of foreign trade have a right to have our doubts as well as our vicarious pride; we can wave the flag, too, and feel that somehow or other we are bigger,

brighter men because America has three-fifths of the foreign trade of Central America and had last year a larger share of South America's trade than England, Germany and France combined. At the same time, while swelling with the vicarious pride, we have our doubts and hesitations. We know, for instance, that when American bankers have made loans to Santo Domingo and Haiti, their loans have been predicated upon a frank declaration of the responsibility of the United States for the collection of certain of the revenues of those states. We know that in the case of the recent loan to Salvador, there was included a provision by which any dispute which might arise between the bankers and Salvador was to be referred to adjudication by the Chief Justice of the United States Supreme Court; and the bankers—who had submitted their loan contracts, which included even more official supervision than that, to the State Department—felt justified, when issuing their loan circulars, in stating that “it is simply not thinkable that after a federal judge has decided any question or dispute between the bondholders and the Salvador Government, that the United States Government should not take the necessary steps to sustain such decision.”

Some of us are a little worried by the national responsibility in connection with some of the loans which the State Department seems to be loading upon our innocent shoulders—to which Senator Glass refers in his criticism of this policy. When an executive department asks bankers to submit loans to it, and assumes the privilege, in some cases, of asserting its powerful disapproval—without any legislation, without any specific grant of power by Congress—it inevitably seems to the world to assume an implied responsibility for those loans. The most explicit disavowals do not relieve it of that burden; the fact that it kills certain loans by its disapproval, and passes others, is an acceptance—or so it must seem—of a measure of moral responsibility. That is a portentous fact which the bankers, the government, and the public must face.

Indeed, no American banking firm can today lend money to a foreign country without involving to a certain degree the position of the United States. A banker cannot even, under present-day circumstances, travel abroad, discussing loans, without involving the United States in international compli-

cations. The policy of the government and the circumstances of the day make him more than a private citizen—a sort of unofficial ambassador. It is a dangerous position.

I received a letter three days ago from China. I don't want to assume the slightest responsibility for any suggestion in this letter: I simply want to point out that Mr. Thomas W. Lamont cannot go traveling even on what he announced as a mere pleasure trip, without upsetting to some slight degree the balance of the Far East. This Shanghai letter says:

My dear Gannett:

There are all kinds of rumors in circulation here regarding the real purpose of Thomas W. Lamont's trip to Japan, so I am wondering which is the correct interpretation. One of the reports is to the effect that Lamont is planning a large loan to the South Manchurian Railway for the alleged purpose of assisting the Japanese in fighting the Russian influence in that area, but the real purpose being to enable the Japanese to consolidate their position in North China with the idea of ultimately annexing Manchuria. . . . Then there are other rumors in circulation, that Lamont is cooperating with the British in the old scheme of trying to weld a ring around. . . .

I do not need to continue and I do not want to endorse any of these rumors. I do want, however, to insist upon the fact that Mr. Lamont's "pleasure trips" become a matter of first-rate national and international importance. If, in behalf of the house of Morgan he negotiates a loan to Japan or to its South Manchurian Railway, that loan will be submitted to our State Department, and it will be assumed in foreign countries, despite the most specific denials which the Department of State may make, to have the specific approval of the State Department, and to represent United States Government policy. So long as bankers are virtually required to submit their loans to the State Department before issuance, we shall have that condition. But even if the State Department abandoned this procedure, a second difficulty would remain. No one, in this country or abroad, is sure what degree of governmental protection will be given to foreign loans and investments. As a matter of fact, of course, we intervene "to protect American lives and property" only in small or weak countries. It is not simply a matter of governmental loans; the most innocent-seeming investment may, under present conditions, involve us in a small war.

There are many instances in recent history. The original intervention in Nicaragua in 1912, according to testimony of the responsible individuals themselves, before the Foreign Relations Committee of the United States Senate in 1914, came after the representatives of the bank concerned had protested to the State Department against interference with a locomotive and two flat cars which had been seized by the Nicaraguan authorities—American property! Our present domination of all Nicaragua began with the apparently innocuous business of landing troops at one port for the “protection of American lives and property”. So long as you have the theory that the American flag follows the investor wherever he goes, and that he has a right to the especial protection of the American flag when he becomes involved in local revolutions and disturbances, so long will you have a growing danger of international conflicts following the swelling tide of foreign investment.

I should like to throw into this discussion three propositions: First, that the State Department give up entirely its irresponsible semi-control of foreign investments and abandon its present policy of asking American banks to submit, prior to issuance, their loan contracts for its approval. Second, that in place of this we should adopt a policy of requiring American banks lending money abroad to make public their loan contracts, so that before we are involved in trouble the public may know the terms that cause the trouble. Certain recent Central American loans, I suspect, might never have been made had their makers expected such publicity. Finally, I suggest a principle of infinite complication, contrary to international precedent, which can be simply stated thus: That Americans investing abroad do not expect the American Government to provide them, in the countries where they invest their money, with better protection than the citizens of those countries themselves receive.

PART II
INTERNATIONAL TRADE RELATIONS

TRADE BARRIERS AND CUSTOMS DUTIES

NORMAN H. DAVIS

Formerly Assistant Secretary of the Treasury and Under Secretary of State of the United States, and an American Delegate to the International Economic Conference at Geneva

ARTIFICIAL restraints on International Commerce are not new. Governments have always claimed that it was an undisputed prerogative of sovereignty to establish the terms on which aliens could trade within or across their frontiers. The Moorish Corsairs of El Tarifa, near Gibraltar, levying a tax on all commerce through the Straits, gave their name to a practice which was very, very old.

In modern times, tariffs have been imposed not only to raise revenue, but to protect home industry from foreign competition. Theoretically, such "protection" is a subsidy to local producers, which must be paid for in higher prices by local consumers. There are, however, great practical difficulties in reaching any definite appraisal of the amount of this subsidy, who pays it and the effect on the economic life of the nation.

The prosperity or adversity of a country is due to multiple and complex causes, of which tariff policy is only one. The size of the home market; the natural resources; the type and industrial fitness of the population are considerations at least equally, if not more important. It is difficult to prove whether any country is prosperous because of, or in spite of high protection. The three countries today with the highest tariff levels are the United States, Spain and Russia. The standard of living varies greatly in these countries. Obviously a high tariff does not suffice to bring prosperity to a country which is poor in natural resources like Spain, or torn by revolution like Russia.

In the years immediately preceding the War, there was a tendency toward increasing protection. Great Britain alone of the industrial nations believed that its prosperity was enhanced by free trade.

Post-War Period

After the destruction of capital, the loss of man-power, the long interruption of normal production, the obvious impoverishment, caused by the World War, it would seem that long-visioned, broad-minded selfishness would have dictated a policy of closer cooperation between the nations. Only by cultivating existing markets and opening up new ones, by stimulating production, by freeing economic life of its trammels, could the loss be speedily made good. But almost without exception the nations took the other course. Old trading units, like the Austrian and Russian Empires, were broken up not only politically, but economically. The five thousand miles of new frontiers became so many more barriers to the free exchange of commodities. Two fallacies—now generally recognized as fallacies—stimulated this movement. First: many believed that they could best achieve prosperity at the expense of others and that the more they penalized or blocked the trade of their neighbors, the more they would profit. It is pretty generally recognized today that no nation can long prosper in the midst of bankruptcy. The lowering of prosperity, which comes from general blockade cannot be compensated for by protective tariffs. And, secondly, the wave of political “nationalism” which swept over Europe—especially in the near East, where new nations had won their long desired independence—inevitably became economic nationalism as well. Despite the fact that all the trend of our day is towards increasing economic interdependence, the fallacy of “self-contained nationalism” has had a great following. The general staffs became high protectionists, insisting that all the key industries of war supplies should be built up at home. We can picture the confusion, by suggesting that the militia of each of our forty-eight states insist on having their army motor cars built in their own state and be able to impose interstate tariffs which would make it possible for agricultural states to build automobiles in competition with established industrial centers.

This “economic nationalism” meant adding the waste of duplication to the impoverishment of war. New plants, built where they could not be economically operated, were kept

alive by high tariffs. Old plants, which had grown up naturally near fuel or power and raw material, lost their markets as a result of these tariff walls, and so, forced to close down, threw new brigades and army corps into the ranks of the unemployed, which lowered the level of living and the general purchasing power.

Not content with formal and declared tariff war, many nations sought even greater "protection" by embargoes, import and export prohibitions, juggling with terminology in the tariff schedules and complications in customs formalities which further impeded trans-frontier trade. The attack on competitive foreign commerce is often veiled, sometimes taking the form of "sanitary regulations". All sorts of ingenious tricks have been tried to beat the axiom, "You cannot sell abroad, unless you buy abroad".

The raising of tariff barriers was also stimulated by the fluctuation and depreciation of currency. As currencies fell in some countries, tariff walls rose in others as a protection against an influx of cheap goods from the areas of cheap currency. These protective measures were deemed necessary to safeguard home industries, but the closing of markets to the goods of the countries suffering from currency depreciation made it more difficult for them to cure their exchange and currency troubles. Nevertheless, currencies have now been stabilized or gotten within control, but the barriers which were raised against unstable currencies still remain and hamper commerce after the reason for their erection has disappeared.

Tariff revisions have been frequent and almost always upward. Inevitably it is cumulative, for it invites retaliation. If A could raise its own tariffs and persuade the rest of the alphabet to lower theirs, A might gain. But this is not human nature. B, C, D and Z raise theirs in retaliation and the hoped-for gains prove illusions. As it becomes apparent that the profits of this policy of erecting barriers to trade are less than anticipated—that it defeats its own purpose—the losses which all suffer from the slowing down of commerce become even more apparent.

The policy of protection means, in the long run, the sacrifice of the foreign market for the home market. The tendency towards mass production, the outstanding development

of our economic era, demands mass consumption, the largest possible market. An equally important fact of our day is the increasing complexity of industry—mass production is not possible without access to all sorts of raw material. Major industries gather their raw material from the four corners of the earth. A country like our own, with its vast continental area—the largest free trade area in the world—furnishing the greatest part of its basic raw materials, consuming nine-tenths of its production, has been able to pursue a policy which subordinates the foreign market. Nature has been very bountiful to us. Within limits, as yet undetermined, we can live on our own fat, but we are reaching out more and more for raw materials from abroad; our home market is already becoming too small; and we must have additional outlets for our surplus products and wealth.

The typical country of Europe is small; there are relatively few consumers at home. It is lean—poor in raw materials. It lacks the resources and markets essential for economic units of production and distribution. It cannot afford the luxury of a policy of economic nationalism.

The Geneva Conference

The business men of Europe have been seeing with more and more alarm the disastrous results of "economic nationalism" and its accompanying tendency to ever-increasing artificial interference in trade. Uneasiness was being expressed by Chambers of Commerce everywhere. And in May, 1927, there gathered at Geneva the World Economic Conference. Much valuable spade work had already been done by the Preparatory Commission and by the Economic Section of the League of Nations. The information which was given us, in a series of pamphlets, furnished a remarkably comprehensive picture of present economic conditions. Men from every country, men from every special industry could see how their individual problems fitted into the general picture. Viewing the whole in proper perspective, all could see larger significance in the details, with which they were familiar. This matter of tariffs was discussed, not from the viewpoint of any particular manufacturer and his—possibly selfish—interests, but from the international viewpoint, from the viewpoint of the prosperity of all, the viewpoint of the common weal.

Approaching the problem from this angle, it was at once obvious that, while the determination of fiscal policy is a matter of domestic jurisdiction, it is a matter of more than domestic concern. The world has become so interdependent in its economic life that measures adopted by one nation affect the prosperity of others. No nation can afford to exercise its rights of sovereignty without consideration of the effects on others. National selfishness invites international retaliation. The units of the world's economy must work together, or rot separately.

The Economic Conference made no attempt to determine an ideal tariff level—to settle the old controversy between protection and free trade, between high and low tariff. No attempt was made to tell any nation what it should do.

The Conference, however, did reach unanimously, certain very definite conclusions. I do not have to remind you of the composition of the Conference. There were industrialists, bankers, economists, agriculturists, and laborers. It was as authoritative a body of experts in the matter as was ever convened to discuss economic questions. They were unanimous in favor of simplification of customs terminology and formalities; they recommended universal adherence to the unconditional most favored nation principle; they condemned all veiled and indirect methods of increasing the barriers of trade; they pointed out emphatically the difficulties of frequent alterations in schedules. And they agreed that further heightening of the barriers would be disastrous, that the time had come to take the other direction and reduce them.

The Conference was not composed of official governmental representatives. It did not have "power" to bind anybody. But that it expressed the considered conviction of the business world is, I think, proved by the cordial and unanimous endorsement of its findings by the Congress of the International Chamber of Commerce at Stockholm. Even more encouraging is the news that its resolutions have been formally endorsed by the following governments; Germany, Holland, Belgium, Czecho-Slovakia, Austria and the Scandinavian countries.

Armaments

It is impossible to study the question of reducing these artificial "restraints to trade", without being reminded of the very similar problem of the reduction of armaments. In one case, as in the other, the matter comes directly under the sovereign rights of the nations. Any country has a right to build up the military establishment it desires. Any nation has the right to erect such barriers against international commerce as it thinks will serve its interests. But in both cases, the free and uncoordinated exercise of this right has caused great economic burdens and universal embarrassment. In both cases any step taken by one nation to protect its own interests is immediately rendered inadequate by the retaliatory action of others.

It is, I believe, generally conceded that the only hope for the reduction of the burdens and dangers of excessive armaments is through some form of international agreement. I submit that this is also the only method by which we can find sufficient relief from these excessive barriers to trade. International agreement means negotiation, consideration of the other's situation and needs—and mutual concessions.

If each government is to continue, as has been the custom in the past, to fix its customs policy, its military program, as an isolated, individual act of sovereignty, without thought of the repercussion on other countries, the pyramiding of tariffs, the piling up of armaments, is inevitable. We can hope for relief, in the one problem as in the other, only by the method of give-and-take cooperation, by taking the friendly, considerate and broad view.

America's Part

When we come finally to the consideration of America's relation to this problem, we must answer two questions. First: are we sufficiently interested to do anything about it? Secondly: if so, what?

Clearly we have stood in a special position, not so much because of distance—the Lindberghs are constantly reducing that—as because of our structure. International trade has not in the past been as important to us as it is to many European countries, but our export trade, while small in com-

parison to our domestic trade, is rapidly growing in volume and importance, and, with the possible exception of Great Britain, is now greater than that of any other nation. At present, it is largely based on credit supplied by our investors. Purchasers of our products come to us because we have a practical monopoly of the credit they need. We have thus been able to sell our surpluses and let our foreign customers and debtors worry about the trade barriers, but that cannot continue indefinitely.

While I am not a protectionist, I recognize that, with the exception of agriculture, our country has been generally prosperous under a high protective tariff, as it has also been under a tariff for revenue only; and I admit that our consumers have been able to absorb, without apparent detriment to our economic life, the cost of tariff subsidies. We have, however, now changed from a debtor to a creditor nation, which must alter the effect of our tariff upon our economic life and that of other nations. The real test of our tariff policy will come from the need of additional markets and the necessity to safeguard and recover our foreign loans and investments. Whatever our differences of opinion about our own tariff policy, I find little dissent from the proposition that Europe cannot regain its prosperity unless action is taken to reduce these trade barriers—as recommended by the Economic Conference at Geneva.

Mr. Henry M. Robinson, speaking for the entire American Delegation at the Geneva Economic Conference, answered the first question. "Our own experience," he said, "has taught us to consider 'prosperity' as a whole. No industry lives healthily in a period of general depression and instability. No nation can enjoy its full economic activity unless other nations are prosperous. The American people are profoundly interested in the peace and prosperity of Europe."

There is one other point which I submit for your consideration. We, as the growing creditors of Europe, have an added reason to desire the restoration and increase of its prosperity. If we are to continue to lend money to Europe, if we are to be repaid on existing credits, it is to our interest to do all in our power to help Europe in her effort to free herself from this throttling, smothering tangle of artificial trade barriers.

With our increased efficiency, through labor-saving devices and mass production, we have raised our standards of living and our purchasing powers above that of any other country. Instead of being at a disadvantage in competing with Europe, as was formerly supposed to be the case, because of the low wage and standard of living in Europe, it is becoming increasingly evident that Europe is at a disadvantage in competing with us just because of their low wages and low standards of living which reduce their efficiency, their earnings, their purchasing power, and their consumption.

The second question: "What can we do?" remains to be answered. There is unanimous feeling among our citizens that the results of recent cuts in direct taxation have been beneficial. I suggest that a cut in indirect taxation would have an equally beneficial result in our national economy. It would even be more popular, for whereas direct taxation falls mostly on the more prosperous few, indirect taxation bears on all. But it is especially because of its effect on the international problem that I advocate it at this moment.

The experts gathered at the Geneva Conference and the leading business interests represented in the International Chamber of Commerce have expressed the conviction that the removal of barriers which unduly hamper trade would promote the prosperity of all the world. A ten per cent reduction of all of our tariff schedules would be a wise and effective way to set an example in a policy of removing such barriers. It would not work a hardship upon any of our efficient industries, and it would bring relief to many of our people. It would also have an enormous effect upon opinion throughout the world and encourage the adoption of policies which would make the world more peaceful and more prosperous.

CAPACITY OF WORLD MARKETS TO ABSORB EUROPE'S SURPLUS PRODUCTS AND TO AFFORD EMPLOYMENT TO EXPANDING POPULATION

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THE subject assigned to me is a rather ponderous one for treatment within the time limit allowable this afternoon. It is also quite evident that the nature of the subject requires much statement of opinion, based upon data that are incomplete and difficult, if not impossible, to obtain concerning the conditions determining world capacity to produce and to consume. Fortunately, it is not my task to answer the question as to how and when the present barriers to world economic expansion may be removed. I can only attempt to show what may be expected to occur if once the opportunities of possible industrial and commercial expansion are freed from present barriers. I wish to touch upon five points, namely: (1) The nature of Europe's exportable surplus; (2) The present import trade of the world; (3) The capacity to expand world imports; (4) The likelihood of Europe's supplying a substantial share of increased world imports; (5) The capacity to employ expanded population.

Europe's Exports

Although Europe¹ is exceedingly rich in natural resources, its dense population and high degree of industrialization leave but a small surplus of foods and raw materials for exportation to countries outside of Europe. Except for British coal and German-French potash, neither raw materials nor food-stuffs enter largely into European over-seas trade. Typically, Europe's exports are manufactured goods. In 1912, for example, 79 per cent of Great Britain's exports were classified

¹ For purposes of this paper, the term "Europe", unless otherwise indicated, is used to include only central and western Europe; that is, industrial Europe.

as manufactured products; Germany's percentage was 64.6, Belgium's 57, and France's 58.4 per cent. If European exports expand, it must be through manufactured goods. Furthermore, it is in manufactured goods that the chief expansion of over-seas imports must occur.

The potential capacity of Europe to produce industrial goods is very large. With a major share of the world's factory equipment before the war, the war gave increased acceleration to industrial expansion. In some industries, notably steel, ship-building, and cotton spinning, Europe's capacity to produce is not only now greater than pre-war, but greater than existing world demand. In other industries, however, post-war demand has kept pace with expanding mill capacity and in 1925 Europe's actual production of industrial goods was greater than pre-war.¹

While European exports have declined in certain lines, they have increased notably in others, so that, in spite of the fact that the consuming power of the world apparently is not back to what might normally have been expected had there been no war, European exports in 1925 were nearly equal in quantity to the exports of 1913.² The increases and decreases in exports, however, have not been equally distributed over all of Europe. For example, while the exports of cotton piece goods from Great Britain have greatly declined, chiefly due to the falling-off of the Indian market, Belgium, France and Italy are all exporting materially greater quantities of textiles than pre-war.³ In this connection it is significant that the United States imported from Europe three times as much cotton piece goods in 1924-1925 as in 1912-1913, twice as much woolen piece goods, and 50 per cent more of silk piece goods.

New exports have developed. Notably, artificial silk, of comparative insignificance in 1913, has grown into an export of very important magnitude. While the production and ex-

¹ International Economic Conference, *Summary Memorandum on Various Industries*, p. 9.

² According to *Memorandum on Production and Trade*, International Economic Conference, p. 35, the percentage was 96.6.

³ *Summary Memorandum*, p. 22.

port of dyestuffs has greatly declined, other chemicals have increased, notably nitrogen production, which has expanded two and a half fold, displacing to a considerable extent the importation of Chilean nitrates. Ship-building is less today, but the production of electrical machinery has increased in France more than two and a half times pre-war; in Italy over three times; and in Great Britain, over forty per cent.¹ Even the imports of electrical and industrial machinery from Europe into the United States, a machinery-exporting country, have much more than doubled in value, though not in quantity.

These facts, among others of similar nature, are eloquent not only of Europe's continued power to produce, but of the already growing capacity of world markets to consume European fabricated goods in spite of the great handicaps production and trade have encountered during the post-war years.

The Present Import Situation

According to the *Memorandum on Production and Trade* issued by the Economic and Financial section of the League of Nations² the total quantum of imports into the various countries of the world, including European nations, was greater in 1925 than in 1913 by only five per cent. Imports into North America, however, during this same period increased in volume 37.6 per cent; for the Caribbean countries 26.6 per cent; for Asia 24.2 per cent; for Oceania 32.5 per cent; for Africa 1.6 per cent. South America showed a decline of 3 per cent and European imports were less. Aside, therefore, from South America, there has been a very material increase in the import consumption of the non-European world since 1913; and the increase in importations during the last three or four years has been marked.

The post-war growth of imports by absolute values into typical non-European countries and the place that Europe occupies in supplying those imports are shown in Table I.

¹ *Summary Memorandum*, p. 16.

² P. 35.

TABLE I

IMPORTS OF MERCHANDISE INTO LEADING COUNTRIES SHOWING THE VALUE OF TOTAL IMPORTS, THE VALUE OF THE IMPORTS FROM EUROPEAN INDUSTRIAL COUNTRIES, AND THE PERCENTAGE OF EUROPEAN IMPORTS OF TOTAL IMPORTS¹

Argentina

Value in pesos oro (000,000's omitted)

<i>Year</i>	<i>Total Imports</i>	<i>From Europe</i>	<i>% from Europe</i>
1913	496	391	78.8
1922	689	418	60.6
1923	868	577	66.4
1924	828	539	65.0
1925	876	414	47.2

Japan

Value in yen (000,000's omitted)

1913	729	207	28.3
1922	1,890	379	20.0
1923	1,982	401	20.2
1924	2,453	523	21.3
1925	2,572	399	15.5

Canada

Value in dollars (000,000's omitted)

1913	619	167	26.3
1922	802	163	20.3
1923	893	182	20.3
1924	797	183	22.9
1925	927	202	21.7

Dutch East Indies

Value in gulden (000,000's omitted)

1913	436	265	60.7
1922	691	330	47.8
1923	612	302	49.3
1924	678	315	46.4
1925 values are not given			

United States

Value in dollars (000,000's omitted)

1913	1,792	819	45.7
1922	3,112	917	29.4
1923	3,792	1,084	28.5
1924	3,610	999	27.6
1925	4,228	1,139	26.9

¹ Data derived from *Memorandum on Balance of Payments and Foreign Trade Balances*, 1911-1925, vol. II.

Australia

Value in £ (000,000's omitted)

Includes merchandise, bullion and specie

1913	79	54	68.3
1922	103	60	58.2
1923	131	78	59.5
1924	140	75	53.5
1925	157	82	52.2

Cuba

Value in pesos (000,000's omitted)

1913	140	43	30.7
1922	180	27	15.0
1923	268	42	15.6
1924	289	46	15.9
1925	295	45	15.2

India

Value in rupees (000,000's omitted)

1913	1,83,24	1,45,42	79.3
1922	2,42,46	1,70,46	70.2
1923	2,26,85	1,54,57	68.1
1924	2,43,76	1,63,69	67.0
1925	2,26,18	1,48,13	65.4

China

Value in Haikwan taels (000,000's omitted)

1913	586	146	24.9
1922	975	185	18.9
1923	948	171	18.0
1924	1,039	193	18.5
1925	965	149	15.4

Since 1922, in nearly all the countries here shown the total imports have indicated generally a steady, sometimes rapid, increase. In general, also, imports from Europe into these countries have increased, though less rapidly than the total imports. It is, however, the absolute quantity increase in imports from Europe rather than the percentage changes in Europe's position that is significant. The world has been buying more and more of Europe's exports. The relative percentage position of Europe in supplying manufactured products to non-European countries is declining with the increase in industrialization, but the actual quantity of imports increases and, as the table shows, increases most rapidly into

those countries which are most rapidly developing their manufacturing industries; for example, Japan, United States and Australia. India appears to be an exception to this rule, but Indian industrial development has been very greatly depressed during post-war years.

Because of the unequal areas of various countries, and the great variations in densities of population, it is difficult to get a wholly satisfactory measure of the relative importance of imports to various regions. Perhaps the most satisfactory is the import trade per capita. As shown in Table II, there are two main regions of large imports: first, the highly industrialized sections of northwestern Europe, North America, to a lesser degree, Japan. The second area comprises the developing frontier regions, principally of the temperate zones—

TABLE II

PER CAPITA IMPORTS (1924) IN ORDER OF IMPORTANCE FOR COUNTRIES WITH MORE THAN \$5.00 PER CAPITA

New Zealand	\$156.00	Greece	\$22.00
Holland	124.00	Italy	21.00
Denmark	117.00	Ceylon	19.00
Switzerland	116.00	Japan	17.00
Great Britain	111.00	Esthonia	17.00
Belgium	105.00	Hungary	17.00
Australia	105.00	Venezuela	16.00
Ireland	96.00	Egypt	16.00
Norway	78.00	Portugal	16.00
Canada	86.00	Gold Coast	15.00
Cuba	86.00	Central America	13.00
Alaska	85.00	Peru	12.00
Austria	74.00	Mexico	11.00
Argentina	66.00	Poland	10.00
Sweden	63.00	Philippines	10.00
France	54.00	Paraguay	9.00
Uruguay	41.00	Brazil	9.00
Malay States	37.00	Sudan	9.00
Union of South Africa	36.00	Portuguese East Africa	9.00
Germany	35.00	Colombia	8.00
Finland	34.00	Balkan States	8.00
Czechoslovakia	33.00	Turkey	7.00
United States	31.00	Persia	6.00
Chile	31.00	Siam	6.00
Algeria	29.00	Bolivia	6.00
Latvia	27.00	Ecuador	5.00

Australasia, South Africa, southern South America, and Canada. With the exception of Cuba and the Federated Malay States, the per capita importations into the tropics are very small; likewise, into the densely populated, but backward, countries of eastern Europe and Asia.

It is significant that in the areas of present low per capita imports those sections which have come under the influence or direction of the advanced nations have developed, or are developing, an import trade much greater than similar neighboring regions. For example, the per capita imports into Manchuria amount to \$7 as compared to \$2.12 for all of China. The high per capita importations into Algeria reflect the development in that region by the French, and the large import trade of the Malay States, which has been a recent development, is, of course, a result primarily of the exploitation of the rubber and tin industries under the influence of the west.

The high per capita importations into the northwestern European countries may be taken as typical of the capacity of highly industrialized and densely populated countries to import. Australia and Argentine are typical of sparsely populated but progressive agricultural regions; Japan is illustrative of the capacity of the newly industrialized, but densely populated sections of the Temperate Zone; and Cuba exemplifies the possibilities of the rich tropical sections.

Capacity of Countries to Import Manufactured Products

The capacity of a country to import is, of course, dependent primarily upon its capacity to buy—to buy beyond the ability or the desirability of the country to produce at home those products which its inhabitants demand. The capacity of a country to buy, in turn, rests upon the country's own productive powers; for it is the capacity to purchase that furnishes the incentive and the means for buying. The ability to expand production capacity depends upon the nature and extent of the country's natural resources and the number and quality of its population. A country of great resources occupied by a capable population has the possibility of large productive capacity and will command the attention of investors, of managers, and, if sparsely populated, of immigrants.

For a new country with this capacity for economic expansion there may be said to be two stages in the development of its import trade: first, the period of growth of the country's productive capacity; secondly, having become equipped for production, the period of expansion of the national income when the country's ability to buy is further extended by its increase in wealth, due to increased production.

During the period of growth of productive capacity, large imports of equipment material from the more advanced industrial nations are required. This is the period of road and railroad construction; of the opening of new mines; of agricultural expansion; of the erection of industrial plants, public and private buildings; of hydro-electric installations and public utilities of all kinds; and of all those varied activities of a modern industrial and commercial community that require large amounts of manufactured goods. Depending upon the basic richness of resources and the conditions of economic and political stability, this is a period of large imports, not only of equipment material, but also of consumers' goods for a population of rising living standards. The United States passed through this period during the nineteenth century; Argentina and Australia and Japan are now in the midst of such a period.

During the second period—the period during which the national income expands as a result of the perfection of its equipment for production—imports do not decline, but rather continue to increase in even larger measure; for the buying power of the population has been greatly enlarged and new standards of consumption developed. It is the experience of practically all countries that increased home production results in expansion of imports. This results from the needs of an ever-growing complex industry for better equipment and better materials as new inventions and discoveries and improved methods of production are made known and as the demands of the population are broadened by improved education and economic well-being. Capacity to consume, in all developing countries of reasonably rich resources, outstrips capacity to produce. With every economic advancement, a country's imports increase.

Furthermore, the trade of highly developed nations with

their commercial neighbors generally exceeds by far their trade with less developed nations. England was the chief customer of Germany before the war, taking 14.4 per cent of all German exports. Germany was the second best customer of England, India only taking more of British goods than Germany. And yet these two countries were the most highly commercialized nations in Europe and were the most intense rivals for the trade of third countries. It is significant that in 1924-1925 Germany had come back to third place in the British export trade, being exceeded only by India and very slightly by the United States. Likewise, in 1925, Germany's exports to the United Kingdom were second only to the exports to Holland; and doubtless much of this trade to Holland represented goods in transit to the United Kingdom.

This tendency for developed industrial countries to increase imports is well illustrated in the case of the United States. Table III shows that the total imports into the United States before the war were growing not only in absolute values, but in per capita importance as well. During the years 1901-1905 we imported \$972,000,000 or \$11.75 per capita. In 1911-1915, the imports were \$1,712,000,000 or \$17.46 per capita. That is, imports not only grew in value, but grew more rapidly than our population.

TABLE III
IMPORTS INTO THE UNITED STATES ¹
MERCHANDISE ONLY, IN THOUSANDS OF DOLLARS

Year	Total Yearly Imports (Thousand dollars)	Per Capita Total Imports (Dollars)	Total Imports Manufactured and Semi-manufactured Goods (Thousand dollars)	Per Capita Imports of Manufactured Goods (Dollars)	Per cent Manufactured to Total
1901-1905.	972,162	11.75	401,792	4.85	41.3
1906-1910..	1,344,838	14.82	573,665	6.31	42.6
1911-1915..	1,712,319	17.46	680,439	6.93	39.7
1915-1920..	3,338,354	31.37	1,057,987	9.85	31.4
1921.....	2,509,148	23.22	981,798	9.06	39.0
1922.....	3,112,747	27.55	1,215,624	10.74	39.0
1923.....	3,792,066	32.91	1,492,029	12.93	39.3
1924.....	3,609,963	30.97	1,405,234	11.95	38.9
1925.....	4,220,589	35.66	1,550,818	13.05	36.6
1926.....	4,430,888	37.07	1,680,756	14.05	37.9

¹ Data from *Statistical Abstract*, 1926.

Of greater significance, however, is the growth of our imports of manufactured goods. These increased from \$402,000,000 in 1901-1905 to \$680,000,000 in 1911-1915 in total value, and from \$4.85 per capita to \$6.93 per capita. And this was the period during which the United States vastly expanded its manufacturing industries, and during which its exports of manufactures were increasing more rapidly than any other group of its foreign trade. The consumption of manufactured imports increased fully as rapidly as total imports, in spite of a phenomenal growth in domestic manufacturing, and during a period of high protective tariffs.

The same situation is apparent in United States post-war imports. In 1924, our per capita imports of manufactured goods alone were \$11.95; in 1925, they had reached \$13.05 and in 1926, they jumped to \$14.05.¹ And the post-war period was a period of very high protective duties. Any fears that may ever have existed in the past on the part of European manufacturers that the industrialization of the United States would decrease the demand of the United States for Europe's manufactured products seems rather absurd in the light of these figures. American capacity to consume manufactured products has outstripped even its enormous expansion in industrial production. And the buying power of the United States continues to expand rapidly. As estimated by King,² the national income, which was \$332 per capita for our 100,000,000 inhabitants in 1910, had reached \$779 in 1921; or, in 1913 values, \$452.³ The buying power of the United States per capita would seem to be from three to five times the relatively high buying power of most European countries, and rapidly mounting upward. The United States is today by far the largest single consumer of manufactured imports, as well as the largest producer.

Does this ability of the United States to import constantly increasing quantities of goods indicate a similar capacity for increases in other parts of the world? And to what extent may the United States itself expand beyond its present capa-

¹ Allowance is here made for the estimated increase in population.

² King, *Wealth and Income in the United States*, p. 129.

³ Levin, *Income in the Various States*, p. 256.

city? Answers to such questions must be largely speculative; and yet it would seem safe to hazard certain broad conclusions. Few believe that the United States has reached the limit of its expansion, either in population or in per capita wealth. Because of its size, the richness and variety of its resources, the energy and initiative of its people, the capacity of the United States to consume must remain high and expand beyond its present high rank. Outside of Europe, no region has so many advantages for the support of a large population on a high standard of living; and the opening-up of the large areas of economically backward regions of the world must further add to the possibilities of American commercial and industrial expansion.

Few important non-European countries have advanced as far as the United States in the development of their latent capacities. Even the well-situated temperate zone countries still remain relatively sparsely populated and undeveloped. While none of these regions is comparable both in extent and richness of resource with the United States, nevertheless there are important new areas that still require large equipment to bring them into their full productive power. Such are southern Brazil, Argentina, Chile, and northern Mexico, in Latin-America; South Africa; Australasia; the Balkans, parts of eastern Russia, and Siberia; and Canada and Alaska in North America. Many of these regions are in the stage of economic development occupied by the United States fifty years or more ago. In these regions the need for railroad construction and equipment, for example, is almost universal and after fifteen years of almost total cessation of railroad construction in the world, the amount of such equipment required, once the way is prepared, will be very large. The possibilities of railroad expansion offer enormous opportunities for the exports of products from Europe for many years. The building of highways for motor traffic, likewise, is a crying need in all but a few of these countries and will require not only great amounts of machinery and materials, but will stimulate the demand for motor cars and other equipment. Motor-car importations may be expected to run well into the millions in a few years, if the present indications are not wholly deceitful. Hydro-electric installation for municipal

and industrial purposes, the expansion of factories, the building of cities, the improvements in housing and the growth of living standards in every direction are already creating large demands for supplies from the older industrial nations. The largest per capita importers today are Australasia, Canada and Argentina where the capacity for increased population with increasing buying power is still large. The experience of the United States and the countries of northwest Europe in expanding consumption points clearly to a large expansion of consumption in these new and progressive but under-developed sections of the temperate zones.

We have taken the United States as a type of new country that has reached industrial maturity. In contrast, Japan is an old country of dense population now in the process of being industrialized along modern lines. In that country, the present rate of expansion of imports is even more marked than in the new countries that are in process of development. Japanese imports per capita increased fourfold from 1908 to 1923, from \$4.41 to \$17.21, a greater per capita increase than for any other important country in that period. During this period the already large population of Japan has very rapidly increased—thus making the growth in the absolute volume of imports even much more rapid than the per capita indicates. It is significant of the capacity of a country to absorb imports, that a region so small, so densely populated, and so poor in resources as is Japan should continue to expand both its population and its per capita imports at the same time that its own industries were producing increasing quantities of supplies for its own population and for export. From 1903 to 1913, Japan's exports increased 119 per cent; but its imports increased 130 per cent.

Of the principal manufactured imports of Japan, every item has increased in quantity post-war as compared to pre-war, with the exception of cotton piece goods; and even in this line the decline has been relatively small, and many times compensated by the increases in other lines. For example, cotton piece goods imports, valued at 7.7 million yen in 1913, declined to 5.8 in 1924. On the other hand woollen cloth imports increased six fold, from 10.6 million yen in 1913 to 66.0 million yen in 1924; woollen yarn from 4.7 million to 63.5

million; machinery from 15 million yen to 216 million yen; print paper from 3.5 million to 10.3 million; and so on. With the partial exception of machinery, of which the United States was a principal source, the chief supplies of these increased post-war imports come from Europe. And it must be noted that the increases have occurred during a period of depression in Japan. The national income of Japan today is estimated at only about \$60 per capita, one-tenth that of the United States. This compares with \$113 for Italy and \$130 for Belgium, two countries of dense population in Europe. The buying power of Japan would appear to be capable of expansion in the near future to a degree at least equal to that of Italy and Belgium.

China, similar to Japan in density of population, but much larger and richer in resources, now has less than one-ninth of the per capita imports of Japan. The opening of China to modern economic development—a movement which in spite of revolution and unrest is gaining slow headway—makes this country one of great potential buying power for equipment goods and consumers' goods of all kinds. Even though the western business world has greatly over-estimated the industrial possibilities of China, it still remains true that its capacity to produce, and therefore to consume, is very large. And the equipment of China must depend, in large measure, on the industrial countries of the West. An increase of China's per capita imports to equal that of Japan today, would mean an increase of \$6,000,000,000 over its present imports of \$600,000,000.

The tropical regions are, as we have seen, relatively small consumers of imported products. Only two small areas have developed high per capita importation—Cuba and the Malay States. And in both of these instances, advantages for growing highly specialized crops, under the leadership of non-tropical nations, have been responsible for the expansion of the productive industries that have made possible the import expansion. Other large tropical areas, rich in resources, suggest, at first thought, similar possibilities for economic expansion. There are, however, important limitations to the immediate and rapid development of most tropical areas and hence to the expansion of their capacity to import. We have,

I think, greatly over-estimated the tropics as far as its commercial expansion in the near future is concerned. This is due not only to the climatic and labor handicaps to development present in the rich but sparsely inhabited tropic lands, such as Amazonia; but to the great limitations for economic development of the native populations in the crowded tropics.

We of the western temperate zone countries have been led to estimate the capacity of those crowded tropic lands of the far east in terms of European or American capacity to produce or consume. We have too frequently based our conclusions on physical resources and numbers of people. We have not taken sufficiently into account the human factor. Producing and consuming capacity is a function of the quality of the human beings who inhabit a land as well as of its physical resources and numbers of people. Peoples of low vitality and efficiency limit production and hence consumption. The limiting factors in India, for example, are not resources but peoples. Resources are relatively abundant. The conservatism; the lack of physical vitality and energy; the caste system; the superstitions, religious beliefs and philosophies that dampen ambition and initiative; these not only are handicaps to production but tend to keep standards of living on the lowest plane. These handicaps apparently are due in part to climate and therefore climate itself offers a permanent obstacle to the amelioration of the human limitations to consumption.

I can see no reason for believing that the present low consuming power of most tropical countries will rapidly expand to the standards of the extra-tropical countries. One of the strongest incentives to labor is the incentive to expand one's standard of living. This incentive is largely lacking among tropical peoples. It is one of the pertinent reasons why the tropics remain backward.¹ It has been under pressure or

¹ An Indian economist, Professor R. Mukerjee, thus speaks of the Indian population in his *Foundations of Indian Economics*: "There is no desire for a better, more comfortable living, both among the cultivators as well as among the artisans. There is no competition, no stimulus for improvement, no change in customary wages" (p. 4). "The family system discourages individual initiative, and consequently there is a loss of personal energy. The stimulus to individual exertion being not very great, progress is difficult" (p. 32).

compulsion from outside that advancement has been made in certain tropical areas. That India, after intimate contact with the West for a hundred or a hundred and fifty years and under the commercial and political tutelage of England, should still have a per capita import trade only a little larger than China and less than half that of Japan, is significant. One sees but little promise that political autonomy now so loudly demanded in these tropic lands will accelerate commercial development. Nevertheless, the buying power of the tropics is growing, and will grow, though in my belief, less rapidly than has been anticipated. Equipment goods for plantation agriculture, for mining, for exploitation of other resources, are certainly to be in increasing demand. What has happened in Cuba, in Ceylon, in Java and Sumatra in recent years may be duplicated elsewhere. To say that the tropics will expand less rapidly is not to deny that the industrial nations will not find there important and growing markets.

Will Europe Supply the Imports?

The economic development of the new and backward countries of the earth, we have seen, has resulted in an increase of imports—an importation roughly proportional to the degree of increased production. Importations may decline in the percentage of the total supply of goods consumed; but if the experience of the advanced nations of the west is a safe criterion, the absolute quantity will increase. The interdependence of advanced nations increases rather than diminishes with the increase of wealth and the growing complexity of modern economic life. The demands of new industries for new and better materials, the expanding demands of more advanced peoples for greater quantities and larger varieties of goods, the fact that the advantages of an international division of labor become more apparent as regions become economically more advanced—these all are factors making for increased imports.

To this must be added the fact that the present undeveloped or only partly developed regions of the world are, in general, less well provided by natural advantages for industrial production than is Western Europe. With the exception of the United States, there is no large area so well fitted by natural

conditions for manufacturing as is Europe nor so experienced and well organized for industrial production. Eastern Asia—the most promising third region—is much inferior as far as natural advantages are concerned. The United States has not, on the whole, superior advantages. This does not mean that important industrial developments will not take place outside of Europe and Eastern North America—in South Brazil, in Australia, in South Africa, in India, in Eastern Asia. But, at least under the conditions that make for most effective and economical industrial production the industrial regions of Europe and the United States have enduring advantages in resources, in peoples, in organization, in experience. Under an unrestricted and efficient international division of labor, Europe is well qualified to maintain an advantage in manufacturing. In other words, the great natural advantages of Europe, combined with the advantages of an early start and a population skilled in the practice and art of industry and management, long will make desirable, profitable, and necessary an exchange of products between industrialized Europe and the rest of the world—an exchange in which the outflow from Europe must be chiefly in manufactured goods.

The leadership of Europe as an industrial region is no mere accident. It is not merely a result of an early start, forced forward by the accidents of history. Europe, i. e. the continent as a whole, possesses an unsurpassed combination of favoring geographic, economic, and racial factors. Its resources of soil and forest; of mine and sea; of mechanical power stored in coal, oil, mountain stream and glacier; of easy accessibility to all the world both by land and by sea; of a climate not only favoring soil production but the maintenance of an energetic and resourceful people; all these give a combination of physical resources unsurpassed by any region of comparable area in the world.¹

¹ With an area constituting only 7.77 per cent of the land area of the globe, Europe has 26.5 per cent of the world population, 31.5 per cent of the total world railway mileage, 45 per cent of telegraph lines, 60 per cent of the gross tonnage of the world's mercantile marine. Europe contributed in 1913 over 54 per cent of the world's coal supply and 59 per cent of the iron ore production from some of the largest and finest coal and iron ore reserves of the world. It has 38 per cent of the total developed waterpower. It

Possessing the foundation on which great industrial developments can firmly rest, Europe's fundamental advantages remain essentially unaltered by the events of the Great War. To repeat, no region of equal area surpasses this region in the favorable combination of natural advantages, although the United States may equal it. The large margin of advantage that Europe heretofore has had in supplying the world with manufactured goods has diminished and must further diminish; but it is evident that Europe will be able to continue to produce in large quantities in competition with the non-European regions of the world, most of which are far less favored industrially. By virtue of its competitive advantages, Europe is well fitted to benefit still further by the commercial expansion of the rest of the world. In the long run, it does not seem likely that a well-ordered world will permanently maintain artificial barriers to nullify Europe's advantages, for to do so would be to the detriment of the rest of the world as well as of Europe. Neither would the continued expansion of Europe's exports of manufactured goods necessarily mean the decline of industrial exports from the United States and other manufacturing regions. Adjustments and changes undoubtedly will be necessary in the types of goods produced for export, but the capacity of the world to consume seems so large that the favored industrial sections can all profit.

contributes large percentages of total world production of most of the other important economic minerals, as follows: antimony, 31 per cent; bauxite, 60 per cent; copper, 13 per cent; lead, 30 per cent; magnesite, 95 per cent; manganese ore, 59 per cent; mercury, 79 per cent; petroleum, 21 per cent; platinum, 93 per cent; potash, 99 per cent. pyrites, 90 per cent; sulphur, 42 per cent; zinc, 38 per cent, tungsten, 23 per cent.

Although Europe is thought of primarily as an importer of agricultural products, that continent in 1913 produced large percentages of the world's main foodstuffs:—96 per cent of the world's rye; 52.4 per cent of the wheat; 62 per cent of the oats; 72 per cent of the barley; 21 per cent of flaxseed, and even 18 per cent of the maize. Forty-two per cent of the world's sugar was grown in Europe; 90.6 per cent of the potatoes; 92.6 per cent of olive oil. Europe produced of textile raw materials, 26 per cent of wool, 21 per cent of raw silk, and about 100 per cent of the flax. Of animals, Europe possessed 51 per cent of the world's swine; 42 per cent of goats, 32.5 per cent of sheep and 30 per cent of cattle. Europe has a greater area under forest than the United States, and is estimated to have produced in 1913, 33 per cent of the world's lumber.

Capacity to Afford Employment to Expanding Populations

There remains but scant time to refer to the second part of the long title attached to my subject, namely, "the capacity of the world to afford employment to expanding populations." Here, undoubtedly, is one of the greatest of our problems. The expansion of per capita wealth and consumption cannot, of course, continue indefinitely with the present rate of population increase. According to Professor Bowley,¹ the working population of Great Britain—i. e. the population between the ages of fifteen and seventy—in 1941 will have increased 26 per cent over 1910; of Germany 34 per cent; Japan 32 per cent; United States 50 per cent; and Australia 61 per cent. Even assuming large possibilities of expanding production, the ability to employ these populations must become a serious problem in the course of time. For, it must be remembered, with modern improvements increased production can be achieved with fewer men per unit of product. Manufacturing production in the United States increased 60 per cent from 1910 to 1920 while the number of employees increased but 27 per cent. Likewise for food production, while the acreage in crops from 1910 to 1920 increased 14 per cent, the number of farmers and farm laborers decreased from 12,380,000 to 10,660,000 or 14 per cent, without any decline in yield per acre.²

To some extent the increasing rate of productive capacity of the enlarged population may be offset by shorter hours and the elimination of women and children from industrial work. But it is, of course, impossible for the consuming power of the world, even with greatly expanding standards of living, indefinitely to keep pace with both rapidly expanding population and rapidly expanding per capita production. Nevertheless, so large are the undeveloped areas and resources of the world,³ and so great the probabilities of expanding world

¹ *League of Nations: Estimates of Working Population of Certain Countries*, R. L. Bowley.

² O. E. Baker, "Land Utilization in the United States," *Geographical Review* (January, 1923), p. 18.

³ According to O. E. Baker of the U. S. Dept. of Agriculture (*Geographical Review*, January, 1923, p. 25) the area of arable lands in the tropics now in use is 1,800,000 acres, 600,000 acres being in pasture. There remain

consuming power, that there is reason to believe that before the population limit is reached we will have had ample time to solve the problem of limiting population to a balance with resources—in my opinion a balance that will give to a much larger population an average standard of living much higher than the world dreams of today. The immediate danger in regard to food production does not seem to be under-production, but over-production.

The extension of the capacity of the world to produce and to consume greatly expanded amounts of both foods and goods seems clearly possible and probable. In that expansion of consumption, the European industrial area can be expected to continue to supply a very important proportion of the increasing world demands for manufactured products.

3,200,000 acres of potentially arable land in the tropics. In the temperate zones there are now under cultivation 2,500,000 acres, and in addition 1,500,000 acres of arable lands are in pasture, and a potential 1,000,000 acres of arable land not yet used for crops or pasture.

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THE CONTINENTAL STEEL CARTEL

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THE Continental Steel Cartel (*Internationale Rohstahlgemeinschaft—Entente Internationale de l'Acier*), which came into existence on October 1, 1926, attracted an unusual amount of attention. This was due not only to the basic character of the commodity affected and the political relations between the leading participants, but also to the general assumption that the new combination represented the beginning of the movement toward international industrial agreements which, according to the prognostications of their chief exponents, Loucheur among them, are destined to replace to a considerable extent the politico-economic arrangements, like tariff, commercial treaties, etc., in the post-war economy of nations. To the more objective student of economic movements, the steel cartel marked the reaction from the extreme economic nationalism engendered by the war and a return to the tendency toward international industrial solidarity, so evident prior to the outbreak of the world struggle.

It would be difficult to choose a commodity more significant and better adapted to serve as a basis for resumption of international industrial agreements than steel. This choice could be justified on a number of grounds of which we might mention the most important.

On account of the tremendous military importance of steel, the European steel industry underwent an enormous expansion during the war, and a corresponding deflation after the Armistice, except in the case of Germany, where the currency depreciation and the desire to replace the Lorraine plants were responsible for the construction of additional equipment.

The largest producer of steel in Europe, and the second in the world, was subjected by the Versailles Treaty to territorial losses that were expected to undermine the foundations of its iron and steel industry.

France, a comparatively unimportant factor in the steel

export markets prior to the war, not only acquired very extensive mines and steel plants, but also became a very large exporter, owing to a considerable extent to currency depreciation, a temporary advantage which Germany, with its stabilized currency under the Dawes plan, could not overcome. The currency depreciation factor also served to intensify the competitive capacity of Belgium.

While the enormous increase in the steel production of the United States cannot be regarded as a direct incentive to the formation of the steel cartel, it is safe to assume that it has had a certain psychological effect, not only as a striking evidence of the shift in industrial supremacy, but also as an indication of the potential strength of American competition in the export field. The fact that the growth of the American steel industry was accompanied by a certain decline in the British industry, would naturally serve to accentuate the need of cooperation to protect the position of Europe in the industrial world. If we want to depart from the purely economic field, we might call attention to the political importance of the commercial treaty between France and Germany, and the part played by the steel cartel in paving the way for such a treaty.

Background of the Cartel

The official text of the agreement serving as a basis for the international steel cartel, gives clear evidence of the complicated problems involved, and includes so many finely balanced provisions and reservations, as to throw some doubt on the permanence of the organization. The adjustment of the quotas, the fixing of fines and indemnities, the numerous provisions for denunciation, would all seem to mark it as a very complicated compromise, the result of long drawn out negotiations. A brief description of the background and environment of the negotiations will confirm that impression.

It is safe to say that the cartel owes its existence primarily to the pressure of Germany, and its provisions bear a strong imprint of German influence. While it is continental in its present scope, and offers certain advantages to the other participating countries, Germany's desire to recover her position in the steel industry and to restore the balance so rudely disturbed by the separation of Alsace-Lorraine, the change in the

customs affiliations of Luxemburg from Germany to Belgium, and the temporary separation of the Saar, were undoubtedly the determining factors in the organization of the cartel. All these factors should naturally be considered, not only from the standpoint of their effect on Germany, but also on France and Belgium.

When negotiations for the international cartel were begun in 1925, the world steel situation was radically different from what it was in 1913. While the estimated world production had increased from about 78,000,000 to 89,500,000 tons, the proportion of the United States, including Canada, had increased from forty-two to fifty-four per cent, and the share of Europe had declined from fifty-seven to forty-three per cent. In the export trade the change was less discouraging, since the United States as yet exports a comparatively small proportion of its output. The shift within Europe is no less striking. Germany and Great Britain have been the chief losers, the former on account of the territorial changes involved in the loss of the war, and the latter owing to the falling-off in demand for war supplies and shipping, and the increased cost of production. On the other hand, France and Belgium not only increased their capacity through the territorial realignment, but also became more formidable competitors by reason of currency depreciation. It is estimated by some German writers that the steel consumptive capacity of Germany toward the end of 1925 was about half of the pre-war capacity; the curtailment of production ordered by the German Raw Steel Cartel from August, 1925, to June, 1926, was thirty-five per cent, but it is claimed that some of the larger plants were running only at forty to fifty per cent capacity. This was naturally a serious situation for an industry of the basic character of steel, and while reflecting the general loss of productivity, was also partly due to the post-stabilization crisis from which Germany was suffering at that period. If we add the disruption caused in the whole traffic movement between Rhenish Westphalia and Lorraine, Luxemburg and the Saar, the threatened separation of the Saar industries from their German affiliations, and the inability of Southern Germany to get its supplies from Lorraine, it becomes quite clear that Germany was justified in taking the initiative in organizing the

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steel cartel. In the case of France, the primary factor was probably the desire to take care of the output of Lorraine and the Saar, which, together with Luxemburg, were cut off from the free German market on January 10, 1925, upon the expiration of the five-year term of free admission into Germany provided for by the Treaty of Versailles. An additional factor was the desire to settle the commercial relations with Germany, as it was certain that the organization of the steel cartel and the method of disposing of the Lorraine and Saar products, were the indispensable preliminaries for the conclusion of the Franco-German commercial treaty.

The delay in reaching an agreement was due not only to the difficulties of overcoming the lingering political resistance, but also in adjusting the purely technical points involved. There was first the question of the so-called "contingent agreement" (*Kontingentsabkommen*), which was to fix the proportion of the steel output of the Saar, Lorraine and Luxemburg to be admitted into the German market. As was pointed out, the free admission of the products of those territories into Germany, as fixed by the Versailles treaty, expired on January 10, 1925. The five-year period proved insufficient to enable the trade of the territories to adjust themselves to the new channels, and the problem of disposing of their steel production was still of great concern to the French in 1925. German production had already increased through the construction of plants in Westphalia to make up for the losses involved in the separation of Lorraine. In the case of the Saar, there was the additional complication involved, on the one hand, in the desire of the German producers to keep the Saar iron and steel output tied up with the German domestic cartel system and, on the other hand, in the fact that the Saar competitive capacity was affected, like that of France, by the currency-depreciation factor. The German negotiators, realizing the desire of the French producers to settle the problem of the disposal of the production of the new territories, made the solution of this problem contingent upon the conclusion of the steel cartel, and the two agreements were negotiated simultaneously. There was also, of course, the contingent understanding regarding the commercial treaty, as shown by the provisions of the international steel cartel and, according to some German authori-

ties, a definite commitment as to certain concessions on German steel manufactures in the French tariff.

As finally settled, the iron and steel production of the above mentioned territories to be admitted into the German market will amount to about fifteen per cent of the total German production, of which 3.75 per cent was for Lorraine, 2.75 per cent for Luxemburg, and the remainder for the Saar, with an undertaking on the part of France and Luxemburg not to exceed the 6.5 per cent ratio of exports to Germany. There is no tariff concession involved, and the products are to be handled by the German sales cartels in the same way as domestic products. In order not to interfere with the old connections of the South German industries, it was provided that orders from German consumers may be transmitted direct to the producers of Lorraine and Luxemburg. As the Saar plants belong to the German cartels, their quotas will be handled exclusively by those organizations.

Character of the Agreement

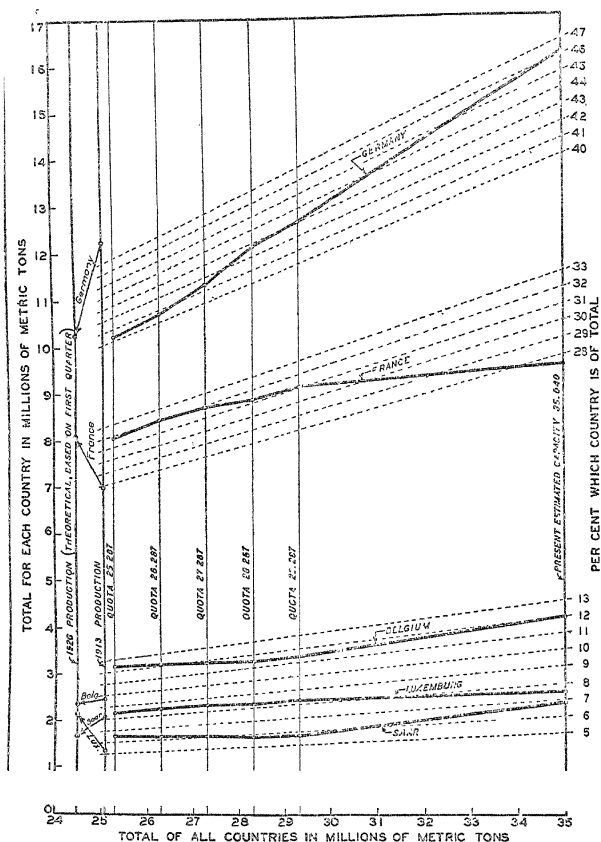
Briefly stated, the international steel cartel proper provides for the fixing of the total output of the participating countries, to be determined quarterly; for quotas for the various countries, fixed for the duration of the agreement, but varying, up to a certain point, with the total output; for the payment of a fixed tonnage fee on the basis of production, penalties for excess production and indemnities for underproduction up to a certain point. It does not provide for price fixing, nor did the original agreement make any distinction between production for domestic or foreign consumption (embodied later as a result of German protest). It contains numerous provisions for denunciation, seven according to one German authority, and its duration is limited to four and a half years, until April 1, 1931. It is evidently of a provisional character, calculated primarily to put a stop to abnormal conditions very detrimental to Germany, in particular, and recognized as the basis for a series of subsidiary cartels involving the fixing of prices and perhaps division of markets. There is no question that the original agreement involved considerable concessions on the part of Germany, induced probably by the hope of later modifications under the pressure of changing conditions that would

eliminate some of the temporary advantages enjoyed by her chief competitors.

One of the most difficult technical problems was presented by the choice of a basis for the total standard production and the fixing of quotas for the participating countries. In 1925, while Germany was utilizing about fifty per cent of her steel plant capacity, France was working at about seventy-five per cent capacity. In 1926, the French production still further increased, under the stimulus of the franc depreciation, while German production underwent a further slump, especially during the early part of the year. Belgium was affected adversely by the strike during a part of 1926, and held out for a higher quota than she was entitled to by her production during the first quarter of 1926, which was finally selected as a basis, with certain modifications. The diagram and table on page 102, based on German sources, shows the final fixing of quotas, their relation to productive capacity and actual production in 1913 and 1926, and the changes in quotas, in accordance with the increase in standard production.

An examination of the diagram shows that while on the initial basis of 25,287,000 tons per year, Germany starts with a quota of 40.46 per cent, her quota gradually increases to 43.18 per cent, as production is increased to 29,287,000 tons, where the quotas become fixed; France's quota, on the other hand, is reduced from 31.91 to 31.19; while the share of Belgium, which remains constant at 295,000 tons monthly regardless of changes in total production, undergoes a decrease of from 12.53 to 11.63 per cent. This brings out clearly the fact that Germany was figuring on an improvement in the steel demand that would raise the total production above the minimum of 25,287,000 tons, since the first quarter of 1926, which was taken as a basis, was a very critical period for the German steel industry.

The provisions regarding contributions, fines and compensations are also very interesting, and show the fine system of checks and balances that was found necessary in order to bring about the agreement. First we have the fee of a dollar per ton from every participating country, which was expected to perform the double function of providing a fund for operating expenses, and also to raise the selling price of steel in view of



Production and Potential Capacity and Quotas for the Countries Constituting the International Steel Cartel.

See note *supra*, p. 108.

the problematic nature of the refund. The second object has not been attained, and it is generally admitted that with the exception of a short period after its organization, the cartel has not been much of a factor in the price situation, owing largely, it is claimed by the German representatives especially, to the loose nature of the agreement and the failure to organize the subsidiary selling organizations for which the main cartel was supposed to form the basis. For every ton produced above the assigned quota a penalty of \$4.00 is levied; this serves to provide funds for the compensation of \$2.00 for every ton below the assigned quota, with certain limitations that serve to reduce the rate of compensation after the underproduction reaches ten per cent of the quota. Production, fines and compensations are calculated every quarter and the funds are distributed every six months, according to actual production, as regards the \$1.00 per ton fee, and according to quota, as regards any surplus remaining after the payment of indemnities. As was easily predicted, Germany has been the chief contributor to the fund as a result of her excess production, largely for domestic consumption, while France, whose domestic consumption has fallen off considerably since the organization of the cartel, has been receiving almost the full amount of Germany's net contribution. Thus, for the first semi-annual accounting period, October, 1926, to March, 1927, Germany's net contribution amounted to \$3,959,000, or at the rate of nearly 51.5 cents per ton produced, while France received during the same period \$3,415,000, or about 81.3 cents per ton. To put it in another form, of the total net contribution for the period from the original members of the combine, Germany contributed about ninety-six per cent and France received about 82.5 per cent, the remainder going to Luxemburg. During the period under consideration, Germany overproduced to the extent of 1,534,000 tons, while France fell short of her quota to the extent of 247,000 tons.

Another provision of the agreement deserving attention is the one relating to conditions for denunciation. According to a German student of the subject, there are no less than seven contingencies under which the agreement can be denounced. Each participating country may give notice of denunciation during the period from May 1 to October 31,

1929; the agreement may be denounced in case of an increase in tariff rates on steel products by Germany; a third contingency which comes into effect after April 1, 1927, is in case of one of the participating countries discriminating against the products of another in the absence of a commercial treaty; a fourth one hinges upon the lapse of the agreement relating to the distribution of the steel output of Lorraine, Luxemburg and the Saar (*Kontingentsabkommen*); the development of new competition exceeding a certain limit may give rise to denunciation and the same applies when the semi-annual quota falls below 13,139,000 tons, or when the output of the participating countries in relation to the total output of Europe declines during a six-month period by five per cent as compared with the first quarter of 1926. It is quite evident that in its organization at least the cartel is still in a decidedly fluid state, and that pending further developments it is not to be regarded as a permanent institution.

While the cartel has developed certain significant symptoms during its first year of existence, it has not greatly extended its scope as regards the number of participating countries. The inclusion of Czechoslovakia, Austria and Hungary toward the end of 1926, involves only an additional quota of 7.272 per cent; the joining of Poland, still pending, is of comparatively little significance from an export standpoint. The most interesting possibility, the participation of Great Britain, is beset with so many difficulties resulting largely from the lack of domestic organization, that it is not generally regarded as a factor of immediate significance. The same is true to a certain extent of the organization of the subsidiary selling cartels which are regarded by the Germans as the *raison d'être* of the basic organization. The fundamental difficulty seems to lie in the difference in the organization of the selling end as between Germany on the one hand, and France and Belgium on the other. The high degree of organization in the domestic market makes it possible for Germany to commit the whole industry as regards fixing of prices and division of territory for steel products. In France and Belgium, on the other hand, there has developed during the immediate post-war period a considerable degree of decentralization in regard to exports, and the existing organizations and affiliations are naturally

not very receptive to the idea of a central selling bureau; the fixing of the quota for the various steel products naturally also presents considerable technical difficulties. It is claimed that the European Rail Cartel (Erma), is the only international steel product cartel in good working order. Incidentally, it may be noted that Great Britain is a party to the Erma, which has replaced the pre-war agreement of the same type. The drawn wire cartel has just been signed, after considerable friction, while the selling organization for shapes and semi-finished products is still in process of formation.

Influence of the Cartel

The steel cartel has now been in existence for a year, and it is possible to form some idea as to the way it has been functioning, and the lines of its probable future development. (See table on page 109.) The immediate effect of the cartel was expected to be an increase in export prices that would enable the German producers to participate in the export trade on a more profitable basis and overcome the exchange dumping on the part of the French and Belgian producers. The public utterance of some of the more prominent iron and steel men in Germany after the negotiation of the cartel, clearly indicates that they regarded the \$1.00 tonnage fee as an important factor in the price situation, and the \$4.00 fine as an almost absolute deterrent to overproduction. The experience of the first year has proven that both assumptions were incorrect. After the flurry during the first quarter of the cartel year when prices went up considerably, partly for reasons not connected with the cartel, the price situation has been dominated very largely by the countries whose dumping activities the cartel was supposed to stop, and the German producers, in order to obtain relief from the fines for overproduction, have found it necessary to commit themselves to a sharp restriction of their export activity.

The attitude of the cartel toward fixing the total production quota shows that during most of the period it did not consider itself sufficiently strong to control export prices. Its only weapon for affecting prices is through control of production quotas, but during most of the year the fixing of the total quotas was influenced primarily by the desire to ease the

burden of fines imposed on German producers for excess production, due largely to increase in domestic demand, and not for the purpose of adjusting production to demand, which is supposed to be the cardinal principle in cartel policy.

The first quarter started out with an annual quota of 29,287,000 tons, or 7,322,000 for the quarter; the actual net overproduction was 628,000 tons, of which Germany contributed 575,000. During the second quarter, when the total quota was fixed on the basis of 27,787,000 tons, the net excess production was 988,000 tons, to which Germany contributed 959,000 tons. During the same two quarters France's underproduction amounted to 86,000 and 161,000 tons, respectively. In terms of fines and indemnities, it meant a net contribution of \$3,959,000 by Germany, of which France received \$3,415,000. In spite of the fact that the upward movement in the German demand and the falling-off in the French activity under franc stabilization during the period immediately preceding the inauguration of the cartel clearly foreshadowed the possibility of excess production by Germany, and consequently the payment of fines, the German producers began to voice their protests against the working of the cartel at a very early stage, and there appeared numerous reports regarding the intention of the German producers to withdraw from the cartel; there were also many statements in responsible German papers about the effect of the fine system as a subsidy on the part of German producers to maintain the French producers in their artificial export activity. The basis of the German complaint was that while the principal object of the cartel was to eliminate excessive competition in export markets, the German producers were being penalized for excess production due largely to domestic demands, while the proceeds from the fines went almost entirely to a country whose artificially stimulated exports were a decisive factor in keeping world prices at a level that largely eliminated Germany from the export field. Attempts to obtain a reduction in the fine for excess production proved unsuccessful during the first stages of the discussion, and the only relief obtained for the third quarter was an increase in the total production quota to a basis of 29,287,000, which also meant an increase in the German quota to the maximum of 43.18 per cent. This quota, which has

been maintained ever since, regardless of the fluctuation in the demand of world markets, was granted in return for an undertaking on the part of Germany to restrict exports.

It was quite natural that this situation, combined with the failure of the cartel to perform its primary function of raising prices, failed to satisfy the German producers, who kept up their agitation for further relief from the burdensome and one-sided payment of fines. At the June meeting of the cartel, German wishes were met partly by the adoption of the principle of dividing German production into two classes, one for domestic consumption with a reduced fine of \$2.00 per ton for overproduction, and the other for export, with the original fine of \$4.00 per ton for excess production; this reduction was to affect production for the third quarter of 1927 (and conditionally the second), and the separation between the two classes was to be made on the basis of 72 per cent for domestic consumption and 28 per cent for export. German producers undertook to restrict their exports to the level of the second quarter of 1927. Some attempt was also made toward meeting the German claims for the extension of the effectiveness of the cartel through the organization of subsidiary cartels, and a special committee was appointed to work out the plan for a selling organization for steel shapes and semi-finished products. At the September meeting of the cartel, a still further concession was made to Germany by a reduction of the fine for overproduction for domestic consumption from \$2.00 to \$1.00 per ton; the total production quota was retained at 29,287,000 tons. Some further progress was made in the organization of selling cartels for certain steel products, largely under pressure from the German representatives, but nothing definite as to the final form and scope of the organization has been announced; the most tangible achievement seems to be an agreement on a basis for determining export quotas for shapes and semi-finished steel products. The concessions granted to Germany are contingent upon Germany's partial withdrawal from the export market, which, considering the present price situation and the extent of the domestic demand, does not involve any considerable sacrifice on her part. A change in Germany's domestic situation, involving a falling-off in the demand, and a consequent increase of interest in export markets,

is likely to affect the attitude of the other partners toward concessions to Germany as regards fines and total production quota.

To sum up, while the Continental Steel Cartel is undoubtedly an important development, and may serve as a basis for an extensive organization of the continental production and exportation of steel products, it has so far failed to achieve its principal object of increasing steel prices and the organization of selling cartels for subsidiary products. Its present structure and the compromises it has been forced to resort to in order to retain the German membership would seem to indicate that it has still far to go to become the influential factor in the world steel situation that it was proclaimed to be at the time of its foundation.

EXPLANATORY NOTE TO CHART ON PAGE 102

The production for 1926 is theoretical, based on production for the first quarter, which served as a basis for determining the quotas.

In the 1913 production, the percentage of Germany is calculated on the present territory, exclusive of the Saar. In the case of France, it includes Lorraine; this is done for the purpose of making the figures comparable with those of 1926.

The line which connects the point of the last quota of 29,287,000 tons with the respective point of the capacity line is intended merely to bring out the relations between the highest quota and present capacity, and should not be regarded as indicating a change in the quotas, since the latter do not change beyond a total production quota of 29,287,000 tons.

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RESULTS OF THE OPERATIONS OF THE CONTINENTAL STEEL CARTEL
FOR THE FIRST THREE QUARTERS

I. October to December, 1926

	Quota (ooo tons)	Actual Production (ooo tons)	Production vs. Quota (ooo tons)		Payments (ooo dollars)	Receipts (ooo dollars)
			more	less		
Germany	3,161	3,736	575	..	1,434	....
France.....	2,283	2,197	..	86	....	1,298
Belgium	846	958	112	..	174	....
Luxembourg..	608	598	..	10	....	307
Saar	423	461	38	..	....	3
Total ...	7,321	7,950	725	96	1,608	1,608

II. January to March, 1927

Germany	2,999	3,958	959	..	2,522	....
France.....	2,166	2,005	..	161	....	2,124
Belgium	803	924	121	..	....	3
Luxembourg..	577	583	6	..	....	406
Saar	402	465	63	..	11	....
Total ...	6,947	7,935	1,149	161	2,533	2,533

III. April to June, 1927

Germany	3,160	3,990	830	..	1,680	....
France.....	2,280	2,060	..	220	....	1,580
Belgium	850	920	70	..	30	....
Luxembourg..	610	630	20	..	....	140
Saar	420	460	40	..	10	....
Total ...	7,320	8,060	960	220	1,720	1,720

IV. Three Quarters, October to June, 1927

Germany	9,320	11,684	2,364	..	5,636	....
France.....	6,729	6,262	....	467	....	5,002
Belgium	2,499	2,802	303	..	204	3
Luxembourg..	1,795	1,811	16	..	....	853
Saar	1,245	1,386	141	..	21	3
Total ...	21,588	23,945	2,824	467	5,861	5,861

INTERNATIONAL CARTELS AND THEIR RELATION TO WORLD TRADE

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IT is really astonishing how strong a hold the idea of international combines has got on the public mind. This is astonishing because the public mind in general is distrustful of what you in this country call "big business," and because the public mind classes combines, trusts, and so on, among those things which in life are indeed tolerated but do not meet with public approval. Notwithstanding this hostile talk about combines in general, all the international combines that have been either carried out or discussed, have had indeed remarkably good press-agents. It is not difficult to account for that. It is to be accounted for simply by certain exceptional circumstances of the present world situation created by the war and post-war vicissitudes. For shortness' sake, I want to discuss briefly these circumstances in three groups.

First, of course, in very many cases countries have during the war lost interests and markets all over the world. This does not only apply to the vanquished countries, but other countries also have been ousted from their previous hunting grounds by the circumstances incident to the war. Now it is clear that regaining all these markets, reconquering confiscated patents, building up lost interests, is a very difficult task. On the other hand, it is equally clear that all those interests which stepped into the place of the ousted ones do not feel entirely comfortable in the new situation. This is natural because in many cases inventions, and so on, though you can confiscate them, need to be developed. The old connections, though broken, may go on existing, and so the idea of meeting again to strike a bargain with the old possessors of the particular field is rather likely to arise in the business man's mind, and out of this source quite a number of plans and discussions about international combines have arisen and must arise. So, for instance, within the field of the

chemical industry, which is the most important instance for this class.

Secondly, we have the fact that some countries, having developed their productive capacity much beyond what it was, now want new outlets, and while some countries—first and foremost, the United States—do want new outlets, other countries know that they will be left behind in the race. The most important instance of this latter class of countries is France. Hence the enthusiasm which France has always shown for this idea of international combines, for combines after all have one consequence, among others: they tend to stabilize existing positions. It is a pity I can't give you instances, but I must pass on to point number three.

This is, of course, the case which we usually describe as the dumping from countries with damaged currency, from the countries with low standards of living among the workmen, and countries which have reparations or interallied debts to pay. Interallied debts act economically exactly as reparations do. They are payments which are due, indeed, in consideration of great services rendered, but not due for commercial value received, and whether you have to claim payments out of loans you gave to your allies during the war or whether you have claims out of reparations, it amounts to much the same thing. Now all these countries are forced to export. It is quite natural that the mechanism of the market should enable them to export, and if the other countries are to defend themselves against this wave of commodities which would otherwise deluge them—I do not discuss the wisdom of defending oneself against a plethora of commodities—if they want to defend themselves against it, anyhow, they are all naturally struck with the idea, that the best thing they can do is simply to reach some agreement in the form of an industrial combine. Industrial combines, private agreements, as they are, have this additional advantage, that you can conclude them and be quite friends with each other, while governments are not. Now it is very difficult for a government to take the right economic course of action. To give one example, it is impossible for France, politically constituted as she is at the present moment, to be anything but hostile to Germany, because the only plank on which the parties forming

the government coalition agree, is precisely the nationalistic feeling. They have not one point in common, apart from that. So the government majority would have to disappear at once, if this point didn't exist, and while the government therefore must take up a hostile attitude, it is just as well to have alongside of such official politics another policy, a private one, of agreement. It is from these particular, and in their nature, transitory causes, it is on this field of transitory arrangements, that we must look for results in the near future.

But, of course, this is not all. The fundamental trend towards international combines is rooted much more deeply. The movement towards international combination is the natural and inevitable outcome of the movement towards concentration and national combination in general.

We have come to look on trusts in a milder and brighter way than we used to. We have come to realize that although we might prefer competition and although all the arguments about anarchy of competition and wastefulness of competition may not be much good, still there is this much truth in them: industry itself outgrows the limits set to the industrial unit by competitive conditions, industry outgrows that size which is compatible with competitive conditions. So you must have trusts, you must have combines, which are in their very nature monopolistic, and even if you don't want them, you have got to have them. There is no use repining for those good old times when we traveled in mail coaches. We have got to have railways now, and the railway must in some measure have a monopoly. There is no remedy against it.

Now, granting this, and granting furthermore that these interests will procure tariffs for themselves, you have then on the world market the condition of a perfectly unrestricted competition, a competition, that is, which is not restricted by that machinery which otherwise regulates production—the machinery of costs. Irrespective of costs, the markets in the world are flooded with commodities flowing from those countries in which trusts produce under sheltered conditions. Having sheltered and stabilized conditions at home means, naturally, a cut-throat competition and very unsheltered conditions abroad. This also is inevitable, and it is

inevitable that this state of things should in the end prove intolerable to all parties concerned; and so the distant future must belong to international combines which will do away with dumping and with tariffs, and the like, in some measure at least.

Of course, people who from a free-trade standpoint rejoice at this sort of thing because it does away with tariffs or makes them superfluous in some respects, are woefully mistaken. The tariff is done away with, but what the tariff is calculated to do, is done much more efficiently by the combine, so the free-trader has little reason to rejoice. But what I want to point out principally is that the temporary causes of the movement towards international combination, which I referred to before, are really coincident with a trend that goes much deeper: they are only helping along what would come to pass anyhow.

Now as to the consequences: of course it would be possible, strictly speaking,—and many international agreements have confined themselves to that,—to talk about trade practices, conditions as to sale and credit, and so on, but agreements as to these things do not do what people really want them to do. The end must be agreement about price, about output, and about dividing up the market into well-defined, sheltered, safeguarded provinces. This being the case, it is true that in the first instance all these combines will have very much those results which the opponents of the trust movement claimed that the trusts generally have had. Output restriction means serving the consumer worse than he would otherwise be served, and, for instance, international fines imposed on a party who is in default with regard to some of the duties of the contract are likely simply to be shifted to the national consumer. In short, this international combination will act on national economic life very much as a tax would. This is not exhilarating, but it is of course only one side of the question.

Finally, when people really get to understand each other, there may be exchange of invention, of which so much is said in discussion now. There may be an agreement and a saving from omitting overlapping services, and so there may be a balance of good looming in the future—this is quite possible—just as the modern trust movement within national frontiers

has perhaps already yielded some balance to the good, but, and this is the last point I want to make, this road is very stony and very long. It will take a very long time and a very slow growth to come to really such combines as those of which I spoke just now, and of which I predicted that they may in the end yield a balance to the good. I shall not take the time to explain the immediate difficulties—legal ones and others, because they are obvious, but the whole thing isn't ripe yet. Only under special circumstances you can obtain a lasting result now, organize a really successful combine, but not generally.

It is first of all clear that most of the leading men in all countries are really driven to this spirit of understanding, not because they like it, but because they are acting under the compulsion of business and economic forces. It is just those temporary circumstances which I have enumerated, or rather hinted at, which account for the willingness to agree. Therefore it is easy to account for the phenomenon which you see when people talk about international combines. You will find that leading men come forward very cordially one day, and draw back another day; that they waver in the views they express; that they do not dare take a well-defined position. Nor is it a wonder that this should be so.

One day, a short time ago, I heard a leading captain of industry, neither an American nor a German, make a speech to his associates about the anarchy of competition; about the necessity of general international understanding in a generous spirit. A few days after, to a small meeting of representatives of his subsidiary industries, he denounced the spirit of conciliation; he was strong in support of competition; he was scornful about anarchy of competition, and such silly phrases. I met this man at dinner and I reproached him with these two statements and I said, "So that is what you understand by consistency, is it?" And he said, "Why, yes—no—well, I don't, of course, but when I made the first speech I saw that the situation in my industry was very bad and we were really in for a severe depression. Since that time I have got other figures; things aren't half as black as I thought they were."

That is naturally the spirit of the whole business. A man in practical affairs cannot act according to principles but he

must act according to the duties of today. He is standing on slippery ground; he is met with great difficulties at every turn, and every morning he is presented by his chief secretary with a long list of what he has to do and what he has to worry about, so he does just what the day demands and thinks little of the future—and it is just as well that he doesn't take any definite stand, for definite positions are taken for us by the logic of the things themselves. That is one thing, but even if people did take a more consistent position, they would lack the data on which to proceed. How is it possible for them to agree on quotas, which are of course a very important point in every agreement; how are they to agree about dividing up the markets of the world, if their relative strength isn't tested yet, and the relative strength isn't the strength at the moment but it must take account of possibilities. Also sometimes it is necessary to bluff in the game. So that it is very difficult to have any definite idea about what it is reasonable to content one's self with and to grant to the other fellow.

These things naturally will hamper progress. Impatience is sure to meet with disappointments. But first we can expect that some of the problems of our times will be solved in this way, and secondly we have got to expect, whether we like it or not, that there will be a large amount of international combination later on. When the world outgrows the spirit it is in now, it is quite possible that this movement may show many advantages, may usher in a new period, a new industrial revolution, a new possibility of industrial and technical progress.

[1913]

THE FARMER'S INTEREST IN EUROPEAN TRADE RELATIONS

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ONE still finds many people entertaining, at least subconsciously, the view that American agriculture is a great export industry whose domestic prices are dependent upon world prices registered at Liverpool. Like many other examples of conventional thinking, that view is retrospective—reminiscent of the days when the early flood of western grain and livestock products was being poured into a rapidly industrializing northwest Europe in direct exchange for manufactured products and for capital to finance our railway expansion and our own early industrial building. While recognizing that this was the historic position of eighteenth and nineteenth century America, we should yet be alive to the fact that such an economic role has now been in large part relinquished by the United States to countries of lesser power and metal resources or more primitive industrial development, such as Argentina, Canada, and Australasia. The future ranks of American agriculturists need not expect their fortunes to fluctuate up and down in direct response to the ability of European markets to absorb large bulks of foods, textiles, and other farm products of the United States.

This passing of the specific dependence of the American farmer upon European markets does not, however, mean that he has lost all interest in European trade relations. It means rather that he has come to have a more general interest in the whole web of world trade in which European commerce plays its involved and varied part. Only the merest suggestion of the nature of this widely ramifying interest can be outlined in the present paper. Since, obviously, no single characterization can be made which will apply to the whole of the lengthy category of American agricultural products, it will be convenient to group our discussion under five very general heads, namely, cereals, livestock products, cotton, tobacco, and fruits and vegetables.

The first two of these groups represent typical pioneer products which dominated the agricultural commerce of the late nineteenth century and whose decline in relative importance is very marked. Exports of packing-house products, which Europe took to the amount of 1,987 million pounds in 1900, totalled only 858 million pounds in 1913 and, after the brief stimulation of the war period, have further declined to 365 million pounds in 1926. During this last quarter century likewise, our European exports of wheat (including flour) dropped from a peak of 194 million bushels in 1902 to a trough of 40 million bushels in 1911 and a three-year average (1912-1914) of 85 million bushels. In 1926, with a large crop, exports stood at 112 million bushels, or 57.7 per cent of the 1902 figure. Meanwhile, exports to Europe of the other principal cereals—oats, rye, barley, and corn—dropped from 256 million bushels in 1900 to 11 million bushels in 1914, and amount to but 28 million bushels at present. All told, our European grain market has today but three-tenths the importance it had at the opening of the century.

Of our tobacco exports, Europe customarily took about 75 per cent. This amounted to 306 million pounds in 1900 and about 340 million pounds just before the war. In 1926, Europe's imports of tobacco from the United States amounted to 310 million pounds. While this does not show any clear indication of a downward trend in the actual volume of exports, this 310 million pounds constituted only 65 per cent of the total exports of that year. The European market has of late been far from satisfactory to producers of export types of tobacco in the United States and is characterized by an effort manifest in several countries of Europe to meet their requirements from domestic or nearby sources to as large an extent as possible. On the other hand, exports to China have risen from 459,000 pounds in 1900 to 85,791,000 pounds in 1926, constituting in this year nearly 18 per cent of our total exports. Furthermore, in the case of cigarettes, which are the major item in our exports of tobacco in the manufactured state, China took in 1925 and 1926 64.8 per cent of the total and British Malaya and the Philippine Islands took another 15 per cent, whereas Europe took but 3 per cent. Whether China will be able to maintain this position of importance under her

present economic régime may well be a question of acute concern to American tobacco growers.

Exports of cotton have, in terms of total value, percentage of crop, and steady growth over a long period of time, constituted a more significant item of our foreign trade than any other single agricultural product. They were in 1900 slightly below the high point attained in '98 and '99, but continued to increase thereafter to a new peak of over 11 million bales in 1912 and, in spite of the adverse influences of the post-war period and boll-weevil damage to the crop, have been recovering from the low level of $5\frac{1}{4}$ to $5\frac{1}{2}$ million bales to a new high record last year of $11\frac{1}{2}$ million bales.

These figures are for total exports. When we turn to examine their distribution among the various consuming countries, some interesting phases of the matter come to light. For many years prior to the World War, European takings had amounted to about 95 per cent or even more of the total cotton export movement. In 1919, Europe's percentage was only 81.4 per cent of the very small export of that year and, after moderate increase, again declined to 81.7 per cent in 1926 and 73.3 per cent in 1927. Meanwhile, Japanese takings have risen from less than 3 per cent of our exports during the period prior to the World War to 14.2 per cent of the record-breaking exports of 1927. Note also that cotton exports to Canada have shown a marked increase over their pre-war figure, being now more than double and apparently showing a consistent upward trend. Their greatest relative importance was in 1923, when they slightly exceeded 4 per cent of our total export. The threat that European and particularly British cotton manufacturers might find means to supply themselves to a greater extent from non-American sources will probably melt away as a result of the swing toward heavier production and lower costs in this country. Unless the competitive growth of cotton textile industries in Japan, India, Canada, and other non-European countries should receive a severe setback, it does not seem likely that even in this branch of American agriculture the declining trend in importance of the European market will be reversed. Domestic consumption has, of course, been increasing at a rate even faster than that of any export market, standing at about 4 million bales at the close of the nineteenth century and above 7 million bales today.

Our fifth major group of agricultural exports takes us from the more extensive branches of agriculture to one of distinctly intensive character, but to lines of production toward which American farmers are being increasingly attracted. If we examine the statistics of exports of fruits, vegetables, and nuts, both in their natural state and processed, we find a value total exceeding that of the present shrunken export of packing house products, not greatly inferior to the value of tobacco exports, and roughly more than one-third of the grain crop and nearly one-sixth as great as cotton.

A prosperous Europe in a position to indulge a taste for semi-luxuries would offer an attractive outlet for the expanding product of a branch of agriculture characteristic of our present more mature stage of national development and in which the competition of newer agricultural lands tends to be less severe. As it is, Europe shows a nearly tenfold increase in imports of American apples as compared with 1900, and four and a half times what she took in 1914. Her takings of dried and canned fruits and vegetables amounted to about four times those of 1900, and more than three times those of 1914. At the same time, we should not fail to observe that Cuba took in 1926 twice as great a value of vegetables and vegetable preparations and Canada some three and a half times as great a value as did the United Kingdom, which is by far the most important European customer. Mexico, Panama, and Australia together just about equalled the European takings. In the international trade in fruits and nuts, Canadian imports were practically half as great as those of the United Kingdom, and Mexico, Brazil, China, the Philippines, and Australasia were all good customers comparable to Belgium, Denmark, France, or Norway, but inferior to Sweden, the Netherlands, or Germany, and not in the same class as Great Britain.

Several of these comparisons have served to call attention to the preponderant position of Great Britain in our farmers' European export market. Summarizing the fruit, vegetable, and nut figures, we find that the United Kingdom took 67.4 per cent of the total which moved to Europe in 1926. An even more striking situation is revealed for packing-house products, of which the United Kingdom's share last year amounted to 81.3 per cent. Since the corresponding percentage in 1900

was only 64.7 per cent, it seems evident that the British market has been better maintained than that of the continent during the period of marked decline in meat exports. It is natural to expect this to be the case with hams and bacon, but some surprise may be occasioned by the fact that the United Kingdom in 1926 showed a rise in her relative position as a taker of American lard. In that year, 43.8 per cent of our total lard exports went to the United Kingdom as compared with 37.9 per cent in 1900. During the same period, Germany's takings rose from 34.1 per cent to 38.8 per cent, and those of the Netherlands and Belgium combined dropped from 17.1 per cent to 11.7 per cent. All these figures, of course, raise some question as to the extent to which agricultural products imported are used for domestic consumption as compared with re-exports.

As for the cereals, we find the United Kingdom today taking nearly 40 per cent of our total exports to Europe. This, however, is less than three-quarters of the percentage which she took of the vastly larger exports of 25 years ago. Her relative importance in the export tobacco market is slightly greater than that in cereals and apparently increasing rather than declining. The United Kingdom took 40 per cent of the European total in 1900, 46 per cent in 1914, and 48 per cent in 1926.

Turning to cotton, we find perhaps the most striking situation of all. In the decade following the Civil War the United Kingdom absorbed 72 per cent of our total European cotton exports. In the decade ending 1885, this dropped to 65 per cent and to 59 per cent during the following 10 years. The last five years of the nineteenth century found England taking only 48 per cent of the cotton which we sold in Europe, and this dropped to 46 per cent as an average for the next five years and to 43 per cent in 1910 to 1914 (fiscal years ending June 30). Indeed, the single year 1914 showed only a scant 40 per cent going to the United Kingdom. At the conclusion of the World War, with Germany largely out of the picture, the United Kingdom was again absorbing between 55 and 60 per cent of European cotton takings. But so rapidly has this situation changed during the last few years that today Germany, even with her curtailed boundaries, appears to be on the verge of disputing first position with the United Kingdom.

In the fiscal year ending last June, our exports to the United Kingdom were 2.7 million bales and to Germany 2.4 million. This shows the United Kingdom furnishing a market for 31 per cent of our cotton exports, Germany 28 per cent, and Japan, as previously mentioned, 14 per cent.

In the light of the facts thus far set forth, we may now restate the first and somewhat elaborate the second of the general propositions with which this paper opened. As for the first, it is evident that the American farmer has already found it impossible to enlarge, and difficult even to maintain European outlets for a desired volume of his products in exchange for European industrial goods to be taken by the United States. Not alone does he find the desire of American manufacturers to exploit the home market a definite barrier to European buying of our farm products. He must reckon also with the natural desire of these same industrial interests to permit or invite the entrance of competing agricultural products from such foreign countries as might supply them in exchange for industrial products which our manufacturers are amply able to produce in excess of the needs of the home market.

With this somewhat disheartening situation for the farmers of the United States emerging out of the present trend of world economic organization, the next question becomes: Can another sort of market be developed for a suitably modified offering of agricultural exports? Are there ways of pushing sales of a larger volume of distinctive American products in the expanding consumer budgets of a revived Europe or of fitting them with equal adroitness into the consumption schedules of non-European markets as and to the extent that their purchasing power increases through the revival of their trade with Europe?

In this connection, we must remember that the great agricultural export period of the United States was one in which a tremendous process of industrialization was going on in Europe and during which, both there and elsewhere, the standard of living of millions upon millions of people was being advanced at a rate probably never before equalled in the history of the human family. The quarter century or so which immediately preceded the outbreak of the World War was a period when the economic ambition and organized genius of Great Britain, Germany, France, Belgium, the United

States, and other of the developing trade and industrial nations sketched forth a dream of world development in which the backward peoples should be brought forward and the forward peoples pushed to yet more advanced standards of living as a result of the most energetic trade and productive operations. We all know of the vigor, not to say ruthlessness, with which this benevolent if somewhat mercenary program was prosecuted to the remote corners of South America, Asia, and south and central Africa until the leaders of the grand exploitation fell to fighting amongst themselves in 1914.

Whether, even in the absence of such a check, this market movement would have suffered a reaction due to "undigested civilization" similar to the reactions brought about by "undigested securities," which according to some diagnosticians explain certain recessions of the stock market, is a matter on which we need not here speculate. The fact of present practical significance is that, except in the United States and a few favored spots elsewhere, this process has been suffering a severe check or even a distinct reversal in the years since the World War. The burning question is whether, how soon, and to what extent the renewal of activity and a resumption of the rising standards of consumption, as a result of more active and more efficient production and a livelier commercial exchange, can again be brought to pass.

I have listened with the greatest interest to Professor Roorbach's analysis of the probable trend of recovery of Europe's economic fortunes by the rehabilitation of foreign markets for her industrial products. It seems to me very distinctly that this is a matter of the utmost interest to American agriculture, inasmuch as the recovery of a healthy and vigorous tone to the trade relations between Europe and the less industrialized countries of Asia, Africa, and South America would tend to benefit the market for our farmers' products as could no other single force. This benefit would be of a two-fold character.

First, we might expect some enlargement of our direct outlet to Europe. To a certain extent this would presumably stimulate the market for the old staples as recovery of the once flourishing markets for British, German, Belgian, or other European textile products, cutlery, and what-not might enable the factory workers of those countries to eat more American

pork products and flour, smoke more American tobacco, or wear more American cotton. The share of benefit which the United States might derive from such a market strengthening would be most marked in those products in which our position of comparative advantage is most evident, such as lard and cotton, but this would also include other less staple products, such as apples, prunes, raisins and, under expert promotion, certain processed agricultural products, such as canned goods.

Second, would come a probably more important indirect advantage from the increase of purchasing power in those Oriental, tropical, and other outlying markets to which the exporters of American agricultural products have been increasingly turning in these latter years. A recovery of the pre-war tempo of European commercial activity would also make for a freer market for the silk, tea, spices, tin, wood-oil and rubber of the Orient, the wool, frozen lamb, wheat, and butter of Australasia, and a variety of export commodities of South America, the West Indies, and south Africa. In so doing, it would raise the economic prosperity of these countries and, by increasing their purchasing power, expand their capacity to absorb American prunes and raisins, evaporated milk, tinned butter, and a variety of the more intensive types of agricultural commodities for whose production we have at home a surplus capacity, with labor and capital seeking to secure or at least to retain profitable employment. It would support and perhaps expand the market for flour and even for rice, which is now moving from San Francisco in appreciable amounts. It might possibly add that long-prayed-for inch to the tail of every Chinaman's shirt and even penetrate so far into the remotest corners as to put the initial inches of honest cotton on the most backward and unclad races.

While the drift of affairs in China, Mexico, and elsewhere does not give too good assurance that such a result will promptly come to pass, it grows painfully evident that we need some expansion of external markets if our present cotton acreage is to be maintained in prosperous production and if we are to take care under present standards of productivity of our present agricultural population, who seem so unwilling to shift from husbandry to industry and who will perhaps find little welcome in the latter field as it comes to feel increasingly the impact of returning European competition.

TRADE BARRIERS AND CUSTOMS DUTIES

WILLIAM WALLACE NICHOLS

President, American Manufacturers' Export Association; Chairman, Tariff Commission, National Association of Manufacturers, New York

IN the brief time allotted me, any discussion of the topic assigned to this session would be only discursive and superficial to a degree, and I am sure the Committee, whose understanding is in evidence in the character of its program, had no such idea in inviting my participation. I feel justified, therefore, in choosing my way and for my own purposes I shall take advantage of the hint my title in the program conveys to devote my time to reflections on Mr. Norman H. Davis' admirable paper. I do this with some timidity, I must confess, for I cannot match his lucid and compelling phrases and I can only hope my sincerity may carry conviction.

Our life's experiences color our conceptions of its needs and, although I agree perfectly with the aims Mr. Davis so eloquently discloses, nevertheless I cannot be sure—and I rely on a safe interpretation of the teachings of experience—that the course he proposes will realize the great end I assure him we both seek.

Now it happens that a few weeks ago I was called upon to discuss this self-same subject under a slightly different title, "Barriers to Foreign Trade," before the Associated Industries of Massachusetts. I think if I quote briefly my conclusion, Mr. Davis may find much agreement in our articles of faith. I had indicated the many factors appearing in our foreign trade relations which operate as distinct barriers and I submitted as fundamental much for which our American tariff is distinctly responsible. Often it is not what we do that counts, it is the way we do it. In fact, tariffs and their effects were of necessity the main burden of my argument. Finally, I presented the latest statistics of the Commerce Department to point the present importance of our foreign trade and I closed thus:—

It is that we shall maintain our present status and, for the general good of our country, continue to raise it that I plead for the consider-

ation by industrial America of the ideas enunciated which the American spirit of fair play can be trusted to mold into good business policy. We all want to believe that American genius, manifested in phenomenal mechanical processes, clever sales tactics and intelligent commercial foresight, will continue to excite the wonder and emulation of the world.

But would it not be more to the point and a mark of higher intelligence if we added to our aptitude for material success a broader view of what is involved in developing our commercial contacts with the world so that we may work to the advantage of all in the cause of peace and greater happiness? Thus we would further general civilization by mitigating whatever makes for misery and distress,—conditions which always appeal to our pity and in every calamity have evoked our helpful response with a spontaneity and effectiveness that has inspired universal confidence. After all, we can only reduce barriers to a minimum consistent with certain economic exigencies from which no nation will ever be entirely free; so long as standards of living vary as much as they still do between human beings in different parts of the world, compensatory devices in some form will continue indispensable to the welfare of the respective nations.

We have in this country a host of protectionists who are foreign traders and I am sure they will not agree that "the policy of protection means, in the long run, the sacrifice of the foreign market for the home market." I cannot consent to that myself, yet I am firmly convinced that not only does our national welfare depend on a flourishing international trade but that our future rests on the way we continue to develop that trade. To develop that trade under the proper exercise of that necessary compensatory device, our protective tariff, will be a difficult task, for it requires constant readjustments to meet changing conditions, which is a problem whose solution is still masked in mystery. The one great step to that end was the creation of our Tariff Commission, still very much in the experimental,—almost its embryonic stage, whose real function is not yet comprehended even by the Congress which created it. I perceive here in its development an analogy to our Interstate Commerce Commission which has taken more than a generation to prove itself,—to gain the confidence of our people. To be adequately successful the United States Tariff Commission *must* be organized on an economic rather than a political basis.

This prompts another reflection: Mr. Davis evidently feels the need of more tariff legislation, for only by Congressional

action can the "10 per cent reduction of all our tariff schedules" he recommends, be effected. This contemplates a resumption of that political control in our tariff evolution, from which we have just escaped. We must not forget that Congress can act only by composing differences in opinion as great as our Nation, as diverse as its complex population under the influence of environments of every conceivable variety. It is inevitable, therefore, that any tariff schedule formed under such conditions will be, as the Vice Chairman of the Tariff Commission has so aptly described, "a compromise of opinions, a hodge-podge of conflicting interests, a product of log rolling and favor swapping." In effect, each item thus becomes a guess without regard to the economic law that should give it being. Tinkering with the tariff is to be avoided for more than one reason. Our worthy President's recent utterances on the subject—notably in his speech yesterday at Philadelphia—evinced a breadth of understanding that merits attention.

To assign as a warrant for establishing universal free trade between nations, the remarkable commercial success attained in "the largest free trade area in the world" ignores that which makes the latter possible, namely, the prevailing high standard of living throughout this area with its correlative purchasing power,—controlling conditions never found among peoples subject to unrelated, independent developments. No "international agreements" can correct these inequalities. This does not, however, contemplate the abandonment of international cooperation, common understanding, mutual help in a thousand ways which tend to the common well-being so much to be desired. To sacrifice the industrial progress our compensating tariff promotes would certainly hinder, not help that consummation.

There are many factors besides our tariff, equally effective in creating barriers to foreign trade when we consider that the international good will we are able to attract will largely determine the character and life of such trade. We cannot hope to promote a universal good will by disordered, inconsistent procedure on the part of any of the factors operating abroad on our behalf. The character of our governmental representation abroad therefore becomes of prime importance in the cultivation of this absolute indispensability,—good will.

Herein, the foreign service of our government has a predominating influence. Probably its greatest defect today is the lack of one centralized controlling body in the coordination of governmental activities abroad, a judicious guidance instead of an uninformed independence now possible and not infrequently in evidence to threaten if not actually impair some thriving relationship which has been developed under long, arduous endeavor. The 68th Congress disregarded altogether this requirement in the debates which led to the enactment of the Rogers Bill—the first official recognition of an old, acute need of the first order, to be sure—but by that very act Congress crystallized, as it were, a woeful defect in the Foreign Service of the United States Government, fraught with dire possibilities.

In closing, permit me merely to call attention to a report prepared for the Conference to which Mr. Davis referred by the Association which honors me with its Presidency. This report listed 109 specific obstacles to world trade, 56 of which have no relation whatever to customs duties.

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AMERICA IN THE WORLD STEEL MARKETS

O. H. CHENEY

Vice-President, American Exchange Irving Trust Company, New York

THE steel industry has long been recognized as the barometer of business. If it is, I sometimes feel that it is time it were taken off the wall and given a good shake. And yet, if it is no longer a good barometer, it is frequently a combination of magnifying lens and convex mirror. Because steel is a fundamental industry and a great industry, it often enlarges startlingly some of the problems of all business.

It is in this way that steel at the present moment is a good example of America's vital problems as a creditor nation in the world's markets. In the steel industry, these problems may at this time, perhaps, be more grotesquely dramatized than in other industries—but fundamentally the picture is true for many other industries and largely for business as a whole. The points here suggested for consideration are therefore applicable in a wide and urgent measure to much of the world's current economics.

When the Continental Steel Entente was first announced, the leaders of the American steel industry immediately and publicly expressed their utter indifference. Not only would American producers not join an international steel cartel but they had absolutely nothing to fear from the competition of one. In an address before a steel trade association, prepared some months ago, I ventured to predict that this attitude may, in the not far future, prove to be a little too confident and self-satisfied. The question was raised—perhaps inconsiderately—as to what would happen should some powerful combination of foreign steel producers feel that the Americans have been “kidding” themselves and set out to call their bluff.

It is interesting, therefore, to see that only a few days ago the United States Steel Products Company, the exporting subsidiary of the country's leading steel producers, filed a brief with the Interstate Commerce Commission requesting special reduced freight rates on steel shipped to seaboard for export

in order "to develop and continue the foreign trade of the United States." The two million tons of iron and steel exported by this country are called grotesque as compared with Germany's exports of over five million tons. The brief points out that the American industry cannot compete in the world markets in spite of higher efficiency and greater productivity of our labor because wages abroad are only one-fourth of American wages and because average inland freight rates are about three dollars a ton higher here. The railroads have expressed a willingness to grant reduced rates (not as low as those requested) for an "experimental" period of a year. Incidentally, another leading producer has filed a brief opposing the reduction.

The concern expressed in this brief for America's export trade in steel is not a case of statistical hypochondria—it comes from bitter facts. The United States is producing over 48 million tons of steel a year, over half the world's total, and yet it exports only two million tons of iron and steel annually—less than five per cent. The United States Steel Corporation exports only ten per cent of its production. Germany exported over forty per cent last year, her exports increasing seventy-five per cent from 1925 to 1926, thus taking the leading position which France had in 1925 and Great Britain in 1924. The Continental producers have recovered from the war and last year their total exports exceeded pre-war totals. So far this year the world is ten per cent ahead of last year in steel production—but this country is nearly four per cent behind.

Increasing steel production in Europe under present conditions can only mean a fiercer war for market outlets. In spite of a stringent system of fines some of the parties to the Entente have been exceeding their quotas. The various cartels and selling organizations are having considerable difficulty in keeping their trades properly integrated and content. And yet Europe realizes that cooperation must be more than a word if its steel industry is to survive.

The Continental producers have invaded Great Britain and struck fear into the steel industry there. In defense, some of the British producers have jointly agreed to give rebates to their domestic customers who would promise to buy only

British steel. In retaliation the German producers obtained reduced internal railroad rates on steel for export so as to be able to cut prices.

Even the domestic stronghold of the American producers has been invaded. While imports of foreign iron and steel last year were three times as large as in the pre-war years, they were still only a little more than a million tons, a small proportion of the country's total consumption. But the influence of imports cannot be measured by tonnage—small tonnages and underbidding may demoralize the whole price structure. Conditions during the past year, particularly on the east and west coasts, have been such that American producers have appealed to the government to enforce the anti-dumping laws on a number of lines. In structural steel products, for instance, foreign shipments and quotations have been used by buyers very effectively to break prices, and one patriotic superintendent of buildings in New York issued an order, since rescinded, forbidding the use of foreign beams.

The available world markets for surplus steel hold little promise of peaceful trade. Canada, Cuba, Mexico, South America and Japan are the leading buyers of our iron and steel and of those certainly Canada, at least, should remain a logical market. But there have been striking fluctuations in these markets. In the less developed countries it is a question whether big demands will come before domestic facilities are built up to supply them. India, Japan and Australia are steadily adding to their steel-producing capacity. The world's markets seem to be narrowing as competition increases—the struggle for the Chinese market during the past year is an indication of the future.

There is an average of ten million tons of steel available in this country every year for export, according to the United States Steel Products Company's brief, and we export only about a fifth of that. By exporting ten per cent of its production, the United States Steel Corporation declares, it gives employment to thirty thousand additional men and an income of forty-five or fifty million dollars to 150,000 people, thus "contributing very materially, not only to the proper economic operation of our plants, but to the prosperity of the country as a whole".

Now it is true that the theoretical capacity of pig-iron production in this country in 1925 was fifty-one million tons and the production thirty-six million, while of steel ingots the capacity was fifty-six million tons and the production forty-five million. During the past year considerable capacity has been added by leading companies and during this year production has fallen off. For only three months during 1926 blast furnaces in operation reached the normal output of sixty per cent.

This excess capacity is a continuous threat to the domestic price structure and to profits. Competition in the iron and steel industry has turned from the late Judge Gary's policy of "live and let live" to one of "kill or die". The profits of the steel industry are even below the prevailing low averages. The profits of industries which depend on iron and steel for their raw materials are making on an average twice as big a return as the iron and steel industry. The industry has put \$1,650,000,000 into new plant and equipment since 1914—and yet the profit per ton of steel is practically the same as it was then. The return on existing values of plant and equipment was only 5.33 per cent last year.

Should the American steel industry stand idle and let the foreign steel producers take away its world markets? It should.

What does our export business in iron and steel really mean? As it is now, it is a negligible proportion of our production. And if it could possibly be increased it could only be by a bitter price-cutting struggle. But the export business of Europe's steel producers means the very life of its fundamental industry. The recovery and maintenance of that industry is at the very heart of the recovery of international economic stability. Continued instability would be the price we would have to pay and make Europe pay if we insisted on a growing export market for steel and other commodities.

The steel industry in the United States is not so desperate in its need for foreign markets that this country and the rest of the world can pay that price. The cry for foreign markets is a confession of inadequacy in developing domestic markets. If the American steel producers could devote the energy and thought needed in developing export business against desperate

foreign competition to solving their urgent domestic problems, the returns would be many times greater. It is true that productivity in steel and rolling mills has increased fifty-nine per cent since 1914—but this was accomplished by improvements in plant technology and management and not through the application of scientific research.

Europe is learning "rationalization" from us. It is time now for us to apply rationalization to new problems—to new domestic uses and the development of new domestic markets; to the better integration of all factors of the industry so that there will not be the ruinous friction there now is between steel mill, fabricator and distributor. For example, the potential market for steel frames for small houses alone may prove more valuable than an unstable foreign market won by economic bloodshed. If the steel industry could strive to regain some of the market now being given up to cement, it would not only increase volume but would gain some new efficiency in the process.

The steel industry, like most American industries, is volume crazy—the greatest problem is not the increase of volume but the reduction of costs and the increase of profits. The problems of the new competition have not begun to be solved by the steel industry—the new competition between different industries supplying alternative materials and the new competition between different factors in the line of distribution. The steel industry is little more backward than other industries—but the steel industry, for its own sake and for the sake of the economic welfare of the country, can less afford to be backward.

The steel industry and most other American industries must realize that America is a creditor nation and must adapt themselves to that all-dominant fact. They must realize that it is time to stop trying to apply Main Street economics to world problems—that they must integrate themselves with world industry and at the same time develop their own business. They must realize that America cannot be the world's creditor and the world's factory at the same time—that we cannot insist on the divine right to the world's markets—and also to the divine right to the world's gold.

DISCUSSION

MR. FREDERICK W. KELSEY (New York): There are two observations that have occurred to me in connection with the interesting addresses of the preceding speakers. One is in reference to the United States steel situation as applied to this country and to foreign countries. Those of us who remember United States Steel stock at 8, and see it now at its present price with dividends, must see the other side of the picture, which evidently comes from decreased cost of production. In regard to the tariff, some of us have had the opportunity of seeing at close range how tariffs are made, and I think if Mr. Nichols has gone through that experience, as I dare say he has, he has learned that the inside view is something like this: Before the Committee on Ways and Means of the House of Representatives, where tariff bills are originated and in the Conference Committee where they are finished, it is the man who manufactures the goods and gets the benefit of the tariff who is close at hand and has the ear and the attention of the committees, and the people who pay the tariff are viewed through the other end of the telescope.

The second observation is that the tariffs, when they are once put up, rarely go down. The same influences that put the tariffs up, keep them there, and the President obviously has that same thought and conviction, from his expressions in Philadelphia yesterday. It is my opinion, as the result of some familiarity with the way tariffs are made, that if those points of view, as so well expressed by you, Mr. Chairman, and so well expressed by Mr. Nichols on the other side, could be gotten fairly before the electorate of the country, as also the

¹ The informal discussion following the addresses and papers by Mr. Norman H. Davis, Professor G. B. Roorbach, Mr. L. Domeratzky, Professor Joseph Schumpeter, Dr. Edwin G. Nourse, Mr. W. W. Nichols and Mr. O. H. Cheney, at the afternoon Session of the Conference, is here reproduced in large part, with some abbreviation and omission of platform amenities. It also includes a brief memorandum by Mr. Benjamin A. Javits, of the law firm of Javits and Javits, New York, which he was prevented by lack of time from presenting under the informal discussion at the meeting.—Ed.

question of international amity and the reduction of armaments, which is one of the great causes leading to war, we should all prosper, we should all be better off, all more happy, and the nations would make progress and prosperity better and faster than they are making it at the present time.

DR. JOSEPH MAYER (Tufts College, Mass.): I should like to raise a question in respect to this tariff issue. In the recent negotiations between France and the United States over a new treaty on tariff, the point was brought out by both countries that each is basing its tariff upon an equalization of competitive conditions. To what extent has our Tariff Commission succeeded in basing the tariff rates upon that principle? Our State Department maintains that that is the principle on which we go in answering France, and it would seem from the discussion and from the points that have been raised here, that that is not so; that our tariffs are, as a matter of fact, higher than would be warranted by the plan of equalizing competitive conditions. For those who do not know exactly what that implies, it means trying to measure the costs of production for a given commodity in this country and the nearest competitor or the highest competitor of the United States, and trying to arrange a schedule of duties which will equalize competitive conditions between the two countries.

MR. ARTHUR L. FAUBEL (New York University, and the American Tariff League): In the light of my connection with United States Tariff Commission two years ago, I should like to answer the last gentleman's question and also refer to a statement made by Mr. Davis.

The United States Tariff Commission has been functioning as an organization, attempting to levy a competitive tariff, so-called, since the enactment of the last Tariff Law on September 22, 1922. The Act of September 22, 1922 was passed more or less in the fashion indicated a moment ago, although I wish to take an exception. The people who pay the tariff are very much in evidence, I should say, in Washington, whenever a tariff is levied, as well as the American manufacturers are.

The Act, however, was passed more or less in the way outlined. Since it was passed, the Commission, working under

Section 315 in the so-called Flexible Tariff Law, has been endeavoring to make adjustments in certain of the rates established by that Act of 1922, to make the rate agree with the difference in the cost of producing the commodity in France or in Germany or in Japan, and with the cost of producing it in this country. Thus far the Commission has conducted, or is conducting, somewhere in the neighborhood of one hundred-odd investigations. Some twenty have been completed, and reports on them made to the President. All but one, or possibly two of those have resulted in increases in the duty. Those increases covered wheat and wheat products, butter, sodium nitrate, pig iron, barium dioxide, taximeters, to mention only a few of them.

It is precisely here that I would take exception to the point raised by Mr. Davis in his original talk, namely, that Europe and certain parts of the rest of the world are at a disadvantage as compared with the United States, due to the fact that our higher standards of living and our higher wages make American workmen more efficient and consequently give us a lower per unit cost for the commodities produced. That, Mr. Chairman, I submit, on the basis of my experience with the United States Tariff Commission, is not so. The per unit costs of these commodities that I have enumerated here, and of a dozen others in this country, with our admittedly higher standards of living and our higher wages, have been in each case higher than the per unit costs in the foreign countries.

Referring now to the question of the last gentleman as to the extent that the Tariff Commission is endeavoring to carry out the features of Section 315, I have indicated that the Commission has somewhere in the neighborhood of one hundred investigations under way. That is, of course, a very small number compared with the number of investigations the Committee would have to conduct if all of the commodities in the Tariff Law were to be covered, but in this connection I would mention this point which I think has a bearing, particularly as it relates to the recent French tariff controversy. France, of all of the countries in the world, has been the country which has most objected to the United States conducting these cost of production investigations, the end of which is to be the establishment of a so-called competitive tariff.

MR. FREDERICK W. KELSEY: Has the Tariff Commission recommended any reductions?

MR. ARTHUR L. FAUBEL: Two, I think.

CHAIRMAN DAVIS: Yes, on quail from Mexico, and I imagine it was a difficult task to get the difference in cost of production there.

I want to answer the speaker's challenge of a statement which I made. The highest wages in the United States are paid in the most efficient industries, which are not hiding behind a tariff wall. I do not suppose you will deny that. And in Europe there are certain commodities which are not susceptible of mass production, which they do, of course, produce cheaper than we do. But in my statement I was talking about the development of labor-saving devices and mass production. That doesn't always go. Take, for example, coal: we pay four times the wages to a coal miner that they do in England, but we mine coal cheaper per ton than they do in England. So it is not always the wage that counts, but it is the output of the man and the extent to which the employers are aiding him with other devices to increase his output.

Regarding one question which was asked, the "most favored nation" treatment means that you will treat the nations all the same or you mistreat them all the same. In lots of cases, it is a question of mistreatment, and the French in discussing that question feel that the question of reciprocity should enter into the fixation of tariff schedules between two countries, and we insist that the question of reciprocity has nothing to do with it. The real basic difference is on reciprocity; but we say that we must deal with all nations just the same. If we mistreat one, we must mistreat them all. If we deal fairly with one in one schedule we fix, we must deal fairly with all of them and give them all the same rate.

MR. BENJAMIN A. JAVITZ (New York): Under the various headings in this discussion, I was interested in noting whether any reference was made to the Anti-Trust Laws on the statute books of this country. In a recent study which I made of the subject, and on which I have prepared a brochure, it became quite clear to me that if this country was to effectually maintain its stand for world peace, it would have to find a way by which

it could cooperate with the various industrial combinations now organized or in the process of organization in foreign countries. Wars have their origin, in the main, in the business relationships between nations. We are in a new era of civilization, which makes it more than ever necessary that the business men of the various countries be permitted to come together and to peacefully settle their problems. At this time, business men in the United States only to a limited extent can get together to solve their problems, devise common schemes or plans, or agree upon the conduct of their business affairs. Our Anti-Trust Laws have seen to that. These laws circumscribe even our foreign industrial relations.

Europe has developed the cartel system for the purpose of saving and developing herself industrially. In Europe cartels are dictated by the economic laws under which society functions there. Further, it is the best means of *rapprochement* between countries in order to lessen the dangers of war. The potash, iron and steel cartels, and other recent combinations in Europe, are examples of this tendency.

In the study to which I have referred, I have prepared certain amendments to the Federal Anti-Trust Laws, which I believe would place this country in a position to make its fair contribution towards the realization of world peace. Not alone that, but these amendments are designed as well for the purpose of guaranteeing the continuance and the further development of the present industrial "Era of Good Feeling". The proposed amendments seek (1) to assure to the public all the advantages of combination and monopoly; (2) to limit and avoid the disadvantages of commanding business combinations; (3) to permit the making of fair agreements between business men of this nation and foreign nations. There is no time to detail either the amendments or the reasons for their proposal. Suffice it to say, however, that if the American people are really lovers of peace, and are really desirous of continuing the prosperity which they have had for the past several years, that some action must be taken to liberalize—and that substantially—the Anti-Trust Laws now on the statute books of this nation, whether those statutes were proposed by the speaker, or by others more able and better informed.

PART III
INTERNATIONAL FINANCE AND
WORLD TRADE

INTERNATIONAL FINANCE AND WORLD TRADE

THOMAS W. LAMONT

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MR. WALTER T. LAYTON, the eminent editor of the London *Economist*, will soon address you on the subject of "Europe and World Trade." We are also to have the pleasure of hearing Mr. Jeremiah Smith, until recently Commissioner General for Hungary, on "World Trade and Peace." Your President has asked me to say a word or two on "International Finance and World Trade." That is not an easy thing to do. Nobody knows just how to define "international finance." Many people think of it as a thing of mystery and occult dealings; others are so generous as to say that it is a factor in world cooperation. Still others call it downright wickedness and let it go at that. Without attempting myself to define it, may I point out that while international finance has always existed since the time when Phoenician traders sent their clumsy craft plying about the shores of the Mediterranean; nevertheless, in the frequently accepted modern sense of lending upon a great scale and in large units, international finance has existed for America only since the early days of the Great War?

European Capital for America's Benefit

Prior to that time, as I hardly have to point out, America for years (although in the later ones in diminishing volume) looked abroad for capital. British, and in lesser degree Dutch, French and German capital, was a great factor in building our transcontinental railways and, through the medium of farm loans, even in our agricultural development. Now all is changed. We were the world's largest borrower. Now we are the world's largest lender. Would this change have come about except for the Great War? The result of the War and of the early years following it was, as you know, a heavy repurchase by American investors of American securities owned by foreign holders. An even greater factor was, of course, America's enormous excess of merchandise

exports over imports; such excess for the years 1915 to 1920 alone being over eighteen billion dollars. And now Americans have in recent years been lending abroad on such a great scale that the total investment of American capital abroad is estimated at from twelve to thirteen billion dollars, exclusive of the war debts owed to the United States Government,—the present value of which is figured at almost seven billion dollars. And the gross annual income from this huge total of foreign investments is hardly less than one billion dollars per annum. I do not mean to intimate that there have been no offsetting items of capital transfer from Europe to America. In fact these, in the form of emigrant remittances, tourist payments, foreign banking deposits, etc., run into high totals. Nevertheless I wish to make clear the startling extent to which the general credit situation has been reversed.

A Reversal of the Picture

This, then, is a mighty change, the influence of which has an effect upon the economy and even the daily life of almost every nation in the world. A moment ago I propounded the question—Would this change have come about except for the Great War? To this economists are, I think, inclined to say yes,—although nothing like so soon. America's prodigious natural resources, the industry of her workmen, the amazing ingenuity and efficiency of her industrial organizers could not have been ultimately denied. The results of American scientific management and large-scale production are clearly becoming manifest in our world trade. Back in 1880, 61 per cent of our exports were in foodstuffs and raw materials; only 15 per cent in manufactures. In 1926 the first figure had fallen to 34 per cent, while our export of manufactures had gone up from 15 per cent to 52 per cent. America's pre-eminence, not, I may say, in pure craftsmanship, but in mass production, has become one of the seven wonders of the world.

To the bringing about of this great change whereby America has become the creditor of the world has international finance, so-called, made any contribution? Furthermore, have these activities been in any way constructive? The answer to those questions must lie in the brief history of the post-war years. I am not sure how fully the American public appreciates the

extent and the importance of the assistance which America has fortunately been able to give to many of the problems of reconstruction. The most noteworthy in the early years following the Armistice were the borrowings of the British, French and Belgian Governments in the American investment markets, which totaled \$785,000,000. A portion of this amount was devoted to the purpose of refunding loans made during the War. Another portion was utilized for the important purpose of currency stabilization.

In the work of European reconstruction the saving and rebuilding of Austria under the plan devised by the League of Nations constituted the first task. The international loan necessary in 1923 to set the new plan in operation was underwritten and offered by bankers, acting in concert, of Great Britain, France, Italy, Switzerland, Belgium, Holland, Sweden, Austria, and to the extent of \$25,000,000 of the United States. The second operation was that for Hungary which Mr. Smith here, as Commissioner General, carried out so effectively. The necessary loan there was shared in by bankers of Great Britain, Czecho-Slovakia, Holland, Italy, Sweden, Switzerland, Hungary and again of the United States.

Dawes Plan Loan and Others

Next, three years ago came the great international Dawes Plan loan for the equivalent of about \$200,000,000 to the German Government, over half of which, \$110,000,000, was successfully taken up by American investors. In this the other participating countries were Great Britain, France, Italy, Switzerland, Holland, Belgium, Sweden, and Germany. The \$100,000,000 international loan to Belgium, issued a year ago for the purpose of stabilizing the currency and helping to restore Belgium to the gold standard, was issued one half by American bankers and the other half by bankers in Great Britain, Holland, Switzerland and Sweden. At the same time credits to the National Bank of Belgium were arranged by the Central Banks of Austria, Great Britain, France, Germany, Holland, Hungary, Japan, Sweden and by the Federal Reserve Banks of the United States. Less than a month ago an international loan of \$72,000,000 for the stabilization of Poland was arranged; investors participating through bankers

of Great Britain, France, Holland, Poland, Sweden, Switzerland and the United States, whose share was \$47,000,000. An imposing list of credits for the National Bank of Poland was at the same time arranged by the Central Banks of Austria, Belgium, Czecho-Slovakia, Denmark, Great Britain, Finland, France, Germany, Hungary, Italy, Holland, Sweden, Switzerland, and the Federal Reserve Banks of the United States.

Assistance for Various Countries

When, a few months after the great earthquake and fire of 1923, the Japanese Government looked to friends in the western investment markets for much-needed and much-deserved assistance, the great loan of February, 1924, was issued: \$150,000,000 in America and 25,000,000 sterling in Great Britain. And within the last twelvemonth American investors have bought an aggregate of \$40,000,000 of bonds of the cities of Tokyo and Yokohama, guaranteed by the Japanese Government. When in July, 1925, for the first time the Commonwealth of Australia sought the cooperation of the American market, our investors purchased \$75,000,000 of Australian bonds, 5,000,000 sterling being simultaneously issued to British investors. Since that time the Commonwealth and the province of New South Wales have borrowed in American markets a total of \$90,000,000.

In April, 1925, the British Government determined to return to the gold standard, a step important to American as to British commercial interests. In order to facilitate this vital operation the British Government and the Bank of England found prompt response in New York to their requests for two-year credits aggregating \$300,000,000.

One could go on adding many more to these instances that I have just given. But are these not sufficient to answer the question that I asked a few moments ago, namely, have these examples of international finance been on the whole constructive and helpful to the restoration of a war-worn world to normal conditions? Can we claim for international finance that it has also been cooperative? How could these great, these vital and in several instances most difficult operations have been carried through, if financial leaders on both sides of the water had not sunk their individual interests and worked to-

gether for the benefit of the countries involved? Can you picture to yourselves the days and nights of intricate negotiation, necessarily animated by a friendly spirit of give-and-take, that have for the last four years or more been necessary to complete these efforts to repair the ravages of war?

The Task of Reconstruction

People sometimes say that international finance can make or unmake states, can bring on or prevent war. Fortunately or unfortunately, there is no truth in that dictum. Looking back to July, 1914, I know of no group of bankers in any one of the countries soon to be involved that was not earnestly opposing the very thought of war. But their efforts were powerless against the tides of misunderstanding and passion that finally swept the world almost to destruction. If affairs could have been ordered so that the statesmen responsible for bringing on the great conflict could also have had dumped on their shoulders the task of rebuilding the world, history might possibly have been different! This widespread reconstruction which I describe has been accomplished first through the day-by-day endeavor of the common man. The peasant farmers of France, the artisans of Belgium and of Bohemia, the industrialists of England and Germany: they have been the ones who have been rebuilding the shaken structure of European society. And it has been upon this structure as a basis that the bankers and investors and, if you please, international finance the world over, have been basing their efforts of co-operation and reconstruction. So much as to the efforts and methods and even ideals of international finance since the war.

Does Trade Follow Loans?

Now, if Secretary Hoover (whose necessary absence tonight I deplore with you) were here he might turn to me and say "You have talked much of international finance in its efforts for post-war reconstruction. But how about international finance and world trade which is supposed to be the subject of your remarks? Can you trace a connection between the two?" My answer to Mr. Hoover would be partly in general terms: If American investors, acting through their bankers, had not taken that all-important share in the great Dawes

Plan loan to Germany in 1924, would Germany have been able to recover sufficiently to increase its purchases of American cotton, for instance, from only about one million bales in 1923 to well over two million in both 1925 and 1926; its purchases of copper from 136,000,000 pounds in 1923 to 229,000,000 in 1925? Other American commodities could be mentioned, the sale of which has seemed to be stimulated by European recovery. It is not, however, necessary to go into the detail of these. The dictum, "Trade follows loans", has undoubtedly, as many years of experience have shown especially in the case of Great Britain, a sound foundation in fact. But to attempt to prove it by concrete examples or to assay by any quantitative methods the effect of foreign loans on international trade movements is always difficult.

Increasing Business with South America

I am, however, inclined to think that a good example of the effect of foreign loans in stimulating export trade may be noted in the figures of the comparative trade of Great Britain and of the United States with South America. In the case of South America there are not the counter-movements of investment of South American capital in the United States and Great Britain, and of tourists' expenditures, emigrants' remittances, etc., to such a degree as in the case of the balance of payments between the United States and European countries. Before the war, Great Britain was lending considerable amounts each year to the South American countries. According to the compilations of the *London Statist*, loans to all the South American countries granted by British investors in the five years preceding the war aggregated approximately \$926,000,000, or an average of about \$185,000,000 annually. During the same period, there were practically no South American loans placed in the American market, with the exception of one to Argentina in 1909, equivalent to about \$10,000,000. It is estimated that in 1914 the total of American foreign investments was only about \$2,500,000,000, of which probably not to exceed several hundred million dollars had been invested in South America, chiefly in mining properties. On the other hand, out of Great Britain's foreign investments at that time, totaling some \$20,000,000,000, nearly

three billion dollars had been placed in the South American countries, in government and municipal loans, railways, public utilities and industrial undertakings of various sorts.

What is worthy of note is that during the years following the Armistice, the United States has replaced Great Britain as the chief source of new capital for South America. South American loans publicly issued in the United States during the years 1921 to 1926, inclusive, have aggregated almost \$850,000,000, while Great Britain's for the same period have hardly exceeded \$250,000,000. At the end of 1926, it is estimated by certain authorities that the amount of American capital invested in South America had reached a total of nearly \$2,000,000,000.

Noteworthy Comparisons of Trade

Now let us turn to the trade figures: A compilation of these for seven of the leading South American countries shows that in the four years prior to the war Great Britain supplied an average of 25 per cent of their total imports and the United States only 14½ per cent. Whereas from 1922 to 1925 inclusive Great Britain's proportion fell off to 23 per cent, that of the United States rose to almost 25 per cent. It will be observed that while Great Britain has maintained its proportion of South American imports surprisingly well, the United States has increased its proportion from a level of 14½ per cent before the war to one of 25 per cent in recent years. Is there not manifestly a direct connection between this fact and the fact that American capital in South America now amounts to some \$2,000,000,000, as compared with a few hundred millions before the war? And is it not reasonable to assume that our enlarged share of South American trade will be sustained, if we continue to invest at the rate of \$300,000,000 a year or more in that continent? These are questions which the statisticians of the Department of Commerce are far better equipped to discuss than I. And only the coming years, and the skill and wisdom with which our statesmen as well as our financiers handle their relations with the South American countries, will yield the actual answers to these interesting questions which we ask ourselves.

America's Abundant Good Fortune

Finally, I want to remind you of the great privilege it is to be an American citizen today. This is still the country of great opportunity. The great resources of this North American continent have given us justification for boundless vision, for generous impulse, for glowing optimism, for helpful co-operation in all directions. Just to be born an American, free from some of the clinging prepossessions of the Old World, is in itself an inheritance and a career. America is already first by a long lead in wealth and material prosperity. Already we hold two-fifths the entire world's stock of gold. We produce 54 per cent of its cotton; 45 per cent of its grains; 60 per cent of its copper; more than half of its iron and steel. Is there any field of material accomplishment in which we are not pre-eminent? With these great resources, favored by the gods as we are, can we not afford to ponder on our blessings and to pause, even oftener than we do, to pray that the spirit of understanding and sympathy may be vouchsafed to us; well knowing that, if this earth in coming generations is to be made a more stable, a more gracious and a happier place to live in, the coming of such an era will depend almost entirely upon the conscious cooperation of men throughout the world?

EUROPE'S FUTURE ROLE IN WORLD TRADE

WALTER T. LAYTON, C. H.

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IN discussing the question of Europe's future position in international trade, I shall, of course, draw to a considerable extent upon the work of the recent World Economic Conference at Geneva and incidentally perhaps tell you something about that Conference. One of its most important services was that for the first time it made a very thorough and complete stock-taking of the economic position of the whole world. The first fact established by this survey was that though production is recovering, and during the last three or four years has been returning to higher figures, it is still very low. World production in 1925 as measured by the output of food and raw materials was only slightly above the level of 1913, whereas if there had been no war, it would have been very much higher. In other words, the war has interrupted the steady trend of the last half century and delayed the normal economic growth of a decade. Secondly, the survey showed that whereas the production of the world had been checked and in 1925 was only just about where it was in 1913, the check to international trade has been even greater than the check to production. Thirdly, it showed, as every one would expect, that both as regards production and as regards the international interchange of goods, the trouble is centered mainly in Europe, the figures for which are much lower than those of the rest of the world. Indeed, the stationary world totals are the average between figures representing depression in Europe and prosperity—in some cases very great prosperity—elsewhere.

At the same time this does not mean that the problem is simply a European one; for, as has been said this afternoon, in several of the papers, the prosperity of one part of the world inevitably reacts upon others. This is particularly so in the case of Europe which plays so large a part in the world's economic life. The United States is by far the richest country in the world, but North America is not the richest continent.

PRODUCTION AND TRADE IN 1925 COMPARED WITH THAT IN 1913
(1913 = 100)

	Production	Foreign Trade
Europe	105	89
North America	126	137
Caribbean.....	170	128
South America	135	97
Africa	139	99
Asia	120	136
Oceania	122	132

The production of Europe, taking general round figures based upon the production of all foodstuffs and raw materials, accounts for 40 per cent of the world's production of goods; North America today accounts for 30 per cent, of which Canada may be 2 or 3 per cent, and the rest of the world 30.¹ I want you to think for a short time in terms of those round figures: Europe 40 per cent, North America 30 per cent, and the rest of the world 30 per cent. It is impossible for so large a proportion of the world, from the economic point of view, to be in a state of stagnation without reacting upon the rest. If Europe could be lifted from the stagnation in which she has been, it would unquestionably add further to the economic progress of all other parts of the world. That applies, of course, to the United States as well as to other countries of the world; for even now

¹ The actual percentages shown in the *Report on Production and Trade* are: Europe 38.7 per cent, North America 28.7 per cent and the rest of the world 32.6 per cent. These figures have been criticized in view of an estimate recently published of the national income of the United States which amounts to billions of dollars. This is said to be higher than the combined national incomes of all the nations of Europe. No estimate exists for many countries of Europe. But even if they were available, the comparison would not be relevant until allowance had been made for the fact that the purchasing power of a dollar is much greater in Europe than it is in the United States. Owing to this difference in average prices a billion dollars in Europe represents a much greater volume of commodities and services than the same amount of money in America. As the population of Europe is 504 millions and that of North America 125 millions (the figures are for 1925) the statement in the text implies that one inhabitant of North America produces as much as 3 inhabitants of Europe. Comparative studies of "real" wages in various countries suggest that this rather overstates the higher productivity of the American producer.

Europe buys more than 50 per cent of all that America exports.¹

Is this condition of Europe permanent or is it due to passing and temporary circumstances? In some directions the conditions which have produced stagnation in Europe are unquestionably passing away. For example, the currency chaos which followed the war is nearly over—thanks in no small measure to the cooperation of the United States in helping to produce the stability which we now enjoy in Europe. America has played a very great part in European monetary reconstruction. On the other hand, there are a very large number of factors affecting Europe which are not so definitely temporary. The countries of Europe are left with an extremely heavy tax burden. In proportion to our wealth, Britain is paying about double the taxation that the United States has to pay, and the figures for France and Germany are similar. Again, there is a factor which certainly does not look as though it were passing away quickly. Before the war Russia was a very important and growing economic influence in Europe. Russia's foreign trade had already grown to equal that of India. Today she has a foreign trade less than that of Denmark. Before the war the nations of Europe were looking to Russia both to supply materials and to furnish a market for their goods in an increasing degree, and they had every reason to think that the development of Russia would have gone on rapidly. We may now have to wait a long while for that hope to be realized. Again, the outflow of population from Europe has been checked. It does not seem as though that situation will change quickly for there is no obvious direction in which anything like the pre-war migration stream from Europe can flow.

Finally, there remains the most important consideration of all, namely, the industrialization of distant parts of the world, and in particular the enormous development in the manufacturing activities of the United States. The process of in-

1 DISTRIBUTION OF AMERICAN SALES IN 1925

Europe	53	per cent (of which 21 per cent to Great Britain)
British Dominion.....	19	per cent
Central and South America .	18	per cent
China and Japan	6½	per cent
Others	3½	per cent

100 per cent

[949]

dustrialization in distant countries is not due to the war, but it was tremendously accelerated by it. This process does not necessarily mean, as is sometimes supposed, that nations will become increasingly self-supporting; that there will be less international trade and that in particular Europe will drop more and more out of the picture. On the contrary, the opening up and the gradual industrialization of, shall we say, China or India, the rise in the standard of living of the population which will result from the development of these and other countries all over the world, is likely to lead to *more* and not less international trade. May I refer, in confirmation of that opinion, to the experience of Britain and Germany in the forty years before the war? Germany was developing rapidly and caught us up in many industrial activities which were very similar to our own. The result was not less exchange but *more* exchange of goods which increased so greatly that in the years immediately before the war Germany bought more of our goods than any other country in the world except India, and we were Germany's chief customer.

But while industrialization of different countries and the rise in the standard of living which is likely to accompany it, does not mean less but more exchange of goods, it does mean keen competition, and if under the new circumstances Europe is to hold her own, she must be at least up-to-date and as efficient as her competitors. I do not propose to say anything about comparative efficiency. This is too big a subject and any generalization about Europe is almost certain to be untrue because there are so many different varieties of industrial life in Europe. There is, however, one point on which there will be no dispute, which is that if we are to develop our industrial production in Europe efficiently and well, we must learn from the United States the advantages of large-scale production, of specialization, and of concentration. Unfortunately, something has happened in Europe which is directly opposed to that development. I refer to the fact that the war resulted in the subdivision of Europe into a number of small economic units, many of them too small for efficient production on a large scale. In many cases the result of the division of Europe into small units and the establishment of tariffs around those units has resulted in the attempt to set up in-

dustries within the tariff barriers; there has been duplication of plants; countries have tried to make for themselves goods they formerly obtained by means of exchange; there has been a waste of capital; none of the plants are fully employed, and costs are high, due to part-time working. The calling of the Economic Conference was largely due to the fact that at last, after many years, the business men of Europe have realized that this parceling-up of Europe was a step backward and that it was a grave handicap to Europe considering the international competition we have to face.

The World Economic Conference therefore came to certain conclusions on this point. They unanimously urged the removal of certain types of economic obstruction. They urged that import and export prohibitions should be done away with.¹ The Conference frowned upon the attempt to divert trade from its natural channels by subsidies. It condemned export duties. It was against flag discrimination. And, so far as the form of tariffs was concerned, it recognized that the tariff system had got into a state of chaos, and that something would have to be done to reduce it to order. They suggested that tariff nomenclature should be standardized and that the Economic Committee of the League should endeavor to draw up a standard form of commercial treaty so that something like the old trading relations between the countries of Europe could be restored.

But much the most important recommendations of the Economic Conference are its proposals with regard to the level of tariffs. The Conference recognized that the most extreme forms of obstruction—complete prohibitions, license systems, and things of that kind, had in fact been removed, and they say that “to this fact must be attributed in part the recovery of world trade which has so far been achieved. Tariffs, on the other hand, which in recent years have shown a tendency to rise, are for the most part higher than before the war and are at present one of the chief barriers to trade. The increase in most countries is almost wholly due to higher duties on manufactured articles. In Europe the problem has been complicated by political readjustments which have changed

¹ A Conference has recently been sitting in Geneva to draft a convention for the abolition of those absolute prohibitions of trade.

many frontiers and increased the number of separate customs units from twenty to twenty-seven." This has involved the setting up of some six or seven thousand miles of new customs frontiers. The Conference added that "The harmful effect of these tariffs upon trade has in many cases been increased through their constant changes which have created an element of uncertainty and made it impossible to place long contracts. The countries have failed to deal with the situation by long-term treaties."

The Conference went on to discuss the reasons why this elaborate and growing tariff system had sprung up, and proceeded—and remember that the report from which I am quoting was unanimously adopted by the representatives of fifty nations, Russia and Turkey alone abstaining from voting—to discuss the fallacies and unsound reasoning which had led to this exaggerated tariff system. It pointed out that the tariffs were no remedy for fluctuations in currency. It would surpass the wit of man to juggle with tariffs quickly enough to follow the erratic and rapid movements of exchanges. It pointed out that tariffs had been raised with a view of securing for countries economic self-sufficiency, but that for the great majority of countries that was unobtainable. "This effort to obtain self-sufficiency," they say, "cannot hope to succeed unless it is justified by the size, natural resources, economic advantages and geographical situations of a country. There are very few countries in the world which can hope to attain it."

Then they discussed another form of tariff which had grown up in recent years, namely, what has come to be known as the *tarif de combat*. Unfortunately, the Conference recognized that tariffs imposed for the purpose of beating down other people's tariffs usually fail to do so, but that the high duties imposed remain long enough to create vested interests, and that then it becomes impossible to lower them again. This is one of the leading reasons for the constant upward tendency of European tariffs.

Then the Conference referred to the argument in regard to national defense; it dealt with the fallacy, so very widespread, that it is better to keep out imports and produce at home, than to secure goods by means of exchange. It referred to the fact that high tariffs tend to lead to dumping, the result

of which is to cause disorganization and chaos in international markets. "This artificially created competition," says the report—and these are carefully considered words—"is one of the most dangerous causes of market disorganization and of economic conflict between nations."

Any one who reads the report will find a discussion of many other aspects of the question. But there are two interesting omissions from the list used in connection with the arguments dealing with tariffs. One is the argument that tariffs, after all, are essential to maintain the standard of living of a country. That is not discussed in the report, because nobody raised it in the Conference. If it had been raised it would have brought out some very interesting facts. For, if you look at the League report on the level of tariffs, you find that the most exclusive countries in the world, from the tariff point of view, are Russia, Spain, the United States and Brazil. Three of these countries have low standards of living and one of them a very high one. If you look to see which countries come next on the list as regards their standard of living after the United States, you find first of all the British Dominions. When you come to Europe you will find Great Britain with Holland and Switzerland at the head of the European nations, all three countries with moderate tariffs, or none at all.¹ Then, as you go down the list, you will come to the countries with high tariffs and low living standards: Poland, Hungary, and so forth. In short, the high tariff countries include nations with both high and low living standards, while most of the low tariff countries have high living standards. These facts would have been a warning against drawing any general conclusion as to the effect of a tariff upon the standard of living, and suggest that there are other considerations which determine the standard of living, which have nothing to do with the tariff.

¹ LEAGUE ESTIMATE OF *ad valorem* LEVEL OF TARIFFS

Spain 41 per cent.

U. S. A. 37 per cent *ad valorem*.

Argentina . . . 29	Poland 32	Italy 22	India 16	Denmark . . . 10
Australia . . . 27	Hungary . . . 26	Germany . . . 20	Austria . . . 16	Holland . . . 6
Canada 23	Czecho-S. . . 27	France 21	Sweden . . . 16	Gt. Britain . . 4
	Jugo-Slav . . . 23		Belgium . . . 15	
			Switz. . . . 14	

There was one other omission. The Conference declared that it did not desire to pronounce on the fundamental principles or protection of free trade. But it was suggested at one stage by the French that it should define "reasonable protection" and declare that tariffs should be limited to the difference between the cost of production in a country and the cost in the most important competing country. The Conference refused to have anything to do with any such definition largely on the ground that any such definition can in fact be used to justify any tariff in the world and that to put in such a definition as a reasonable and proper method of determining appropriate protection would lead to no result in the direction of reducing tariff barriers whatsoever and would be completely ineffective, leaving things exactly as they were.

But the feeling of the Conference was unanimous that the tariff situation had got out of hand; and that so far as Europe was concerned, all countries were losing far more from the high tariffs of their neighbors, than anything that they could possibly hope to obtain from their own, and that something must be done about it. They therefore came to a very specific conclusion, namely, that "the time had come to put an end to the increase in tariffs and to move in the opposite direction." They suggested—and I am only running over this very shortly—that this change should be brought about by individual action, by bilateral treaties, by abandoning the practice of imposing fighting tariffs, and finally—and this was the most important of all—by inviting the League economic organization to endeavor to bring about a general amelioration and reduction of tariffs.

What will be the result? First of all, is this report a genuine expression of opinion? I think in the first place it is a very remarkable fact that such a report, categorical and clear in its indications, was passed unanimously by a very representative body. It is perhaps specially significant that the personnel of the Conference included a considerable number of the actual officials engaged in tariff making, whose whole life was spent in negotiation, drawing up of schedules, and so forth. The Conference further included the presidents of the chief industrial organizations of the countries of the world, of the labor organizations and many others. That unanimity was in itself

remarkable. It is even more remarkable that since the Conference the report has been endorsed completely and in principle by the Governments of Germany, Holland, Belgium, Czechoslovakia, Austria, the Scandinavian countries, and Great Britain.

But words are after all not the true test. Is anything actually going to happen? There are one or two points in that connection worth noting. The first is that Germany has taken the initiative in setting to work to prepare a lower tariff, which will go into operation if other countries show any willingness to fall into line. That is in all events an earnest of good intention. Further we have seen the signing of the recent Franco-German Treaty—the first treaty of the kind for many decades past. On both sides this treaty is admitted to have been largely the result of the Economic Conference. Lastly, the League has already, under the instructions of the Council, begun to set up the machinery needed to give effect to the resolutions of the Conference and in particular the machinery to endeavor to discuss and organize this downward movement of the tariff.

But can anything of a general kind be accomplished? That is a more difficult question. It was generally agreed at the Conference that we could not expect much to be done by individual action and must look, therefore, to collective action. The American representatives who came to the Preparatory Committee, and others, have from time to time pointed out that the United States has an enormous economic advantage in the size of her colossal market within which there are no tariff barriers, and have suggested that Europe might gain prosperity by following the same road. That argument has gone home; it has been meditated upon and much discussed in Europe. But we are a long way from any possibility of a customs union in Europe. There are racial difficulties; there are language difficulties; there were difficulties in forming the confederation of the United States; these were as nothing compared to the difficulties of trying to bring about a unification of the nations of Europe. If an economic federation of the whole or part of Europe is to be attained, it must be attained by degrees. How are you to get at it by degrees?

Certain of the countries of Europe have definitely suggested movements in this direction in recent years. Preferential ar-

rangements have been proposed which would lower the rates between two or more adjacent countries. Every attempt of that kind has hitherto broken down before the opposition of certain other countries, including the United States and Great Britain, which have opposed all such movements on the ground that they are a form of discrimination. For instance, when I was in Austria there was under discussion a proposal for a preferential arrangement between Austria and Czechoslovakia, which was an attempt to move back towards the situation of the old Austro-Hungarian Empire before the war. But Britain and other countries were opposed to a plan which would have admitted Austrian goods into Czechoslovak markets on better terms than British and other foreign goods. It is true that there is a difference between the argument as used by Great Britain and the argument as used by the United States. In the one case our argument is that it is reasonable that we should get into Czechoslovakia on the ground floor, because both Austrian and Czechoslovak goods get into Britain free, with very small exceptions. The argument as used by the United States is that American goods should get into Prague and Vienna on the ground floor, because in the American market there is no discrimination against either Austrian or Czechoslovak goods since both pay the same high tariff.

But where does this opposition lead us? It leads to this: That British policy is directed not to a territorial arrangement but towards a general lowering of the tariffs of Europe. If special territorial arrangements are impossible the only alternative is a general reduction.

Is such a policy possible? The first thing to note is that it has happened before. It is not true that tariffs always move upward, for there have been in European history periods of very definite downward movement of tariffs—not only in Europe, indeed, but in other countries of the world. The most notable case was after 1860, when a downward movement of tariffs was started in Europe by the Cobden Treaty between Britain and France; and in the two decades which followed that treaty, in the period of moderate protection, foreign trade between the nations increased very rapidly. But the situation is not quite the same today as it was then. Then European trade was of outstanding importance from this point of view;

today the problem must be considered not merely as a European problem but as a world problem, if this policy of general reduction is to be followed instead of the alternative policy of a territorial agreement.

I have seen it suggested that the recommendations of the Economic Conference apply only to Europe. But I hesitate to think that economic truth ceases to be truth when it crosses the Atlantic. Moreover, the resolutions of that Conference were not drafted purely for Europe. If they had been—and I am speaking as a member of the Drafting Committee—they would have been very differently drafted. Nor is it true that the tariff problem is today purely a European one. There are many people who have wondered how it happened that members from high protection countries like the British Dominions signed the report that I have briefly described, and have been disposed to think that it was approved with certain mental reservations. Australia is a notable example of a country which has been moving towards higher protection. Did the Australian members think that the tariff movement had gone too far or did they vote for those resolutions assuming that they applied to other people but not to themselves? Let me tell you what has happened since in Australia. Within three months of the Geneva Conference the body which ought to know most about it, the Tariff Board of Australia, presented a very remarkable report, in which it said that "There is a danger of the tariff being used to bolster up the ever-increasing cost of production, irrespective of any consideration of the ever-widening gaps between the standards maintained in the Commonwealth and the United Kingdom." They went on to say that "In so far as the recent increases in customs revenue were due to collection of higher duties, it would have been much better if the money had been left in the pockets of the people, for it had failed in its protective effect." They describe the shuttlecock and battledore situation which goes on; the Wages Assessment Board grants an increase of wages and the industry comes to the Tariff Board for protection to cover the higher wages cost, whereupon there is another appeal to the Wages Board to raise wages to cover the rising cost of living and so on. They conclude that "If Australian industry is to be maintained, the leaders of the trade unions should

recognize the menace of these rising costs of production. Many industries are in jeopardy and unemployment is serious; the situation calls for the serious attention of all parties without political bias, otherwise there could be nothing but disaster." That is a very remarkable statement to come from the Tariff Board of one of the countries which we all assumed at Geneva to be really least interested and least convinced of the principles that had been discussed in the report.

But I must come to the American situation. I realize that here I am on very delicate ground, and I shall need all the charity I can get. I do not propose to discuss the American tariff problem in itself; but I venture to say that however much the United States may consider its tariff as a domestic affair, American tariff policy is bound to influence to a very large extent the tariff policy of Europe and of other countries and will very largely determine the direction in which this new movement in regard to tariffs will develop.

May I recall for a moment the point I began with: that you have on the one hand Europe with 40 per cent of the world's production of wealth, North America with 30 per cent, and the rest of the world with the remaining 30 per cent. The trading relations between the North American continent and Europe are really the key to the future development of the world situation. And what is the outstanding fact? The outstanding fact is that the present trade between Europe and Northern America is comparatively stagnant; that whereas American trade with other continents has gone up enormously, its trade with Europe has remained almost stationary. If you take America's imports from the rest of the world, they have multiplied threefold since 1913. Her exports to the rest of the world have gone up almost by the same amount, nearly three fold. Her imports from Europe have risen by 48 per cent, and when you reckon that those figures are in money and allow for the increase of prices, you will see the justification for what I said just now, that the volume of America's purchases from Europe is no higher than in 1913. It is a significant fact that with all America's internal economic progress and the development of her trade in other directions, her purchases from Europe are no more than they were in 1913. Her sales to Europe have gone up slightly, but very little as

compared with the threefold increase elsewhere. America's exports to Europe are up by 93 per cent, which, after allowing for the increase in prices, places them perhaps 20 per cent up.¹ Between this great continent of Northern America and the rest of the world there has been a colossal development; between Northern America and Europe stagnation, with a slight improvement, though very slight, in exports to Europe. That is hardly what President Harding anticipated when the tariff of 1922 was introduced. In his presidential message of December, 1921, he said, "We must not be unmindful of world conditions but recognize the necessity of buying wherever we sell, and that the permanency of trade lies in its acceptable exchanges. In our pursuits of markets we must give as well as receive." But in any event, the tariff of 1922 has proved to be an anti-European tariff, which has checked trade between Europe and America from developing *pari passu* with the great internal development of the United States, and with its foreign trade in other directions.

It might be suggested that imports from Europe do not matter, provided the United States can sell to Europe, and that the balance can be settled by what is called triangular or round-about trade; but though triangular trade has long played a part in balancing the trade account of America as it does of every great trading country, it has not prevented the stagnation to which I have referred and in any case is not a very satisfactory solution from the European point of view. May I for a moment recall the figures I just gave? It is not the case that America has sold to Europe, that Europe has sold to the rest of the world, and the rest of the world has sold to America, for what has happened is that American trade with the rest of the world, *in both directions*, has increased, and

¹ INCREASE IN THE TRADE OF THE UNITED STATES WITH VARIOUS
CONTINENTS IN 1925 COMPARED WITH 1910-14

	<i>Imports</i>	<i>Exports</i>
Europe	+48	+93
All other Countries	+250	+183

It is of interest to compare with these figures the percentage of imports from various continents which entered America free of duty, i. e. North America, 59.3 per cent; South America, 84.4 per cent; Asia, 83.7 per cent; Oceania, 52.5 per cent; Europe, 37.8 per cent.

increased enormously. America has not left room for the triangular trade of Europe but has naturally endeavored with considerable success to fill these markets herself.

It is true that American sales to Europe can in part be paid for by the expenditures of her tourists, for when all allowances are made for deductions, amounts spent in Canada and elsewhere, the figures look as though American tourists contributed some \$300,000,000 to \$350,000,000 last year toward the balancing of American sales to Europe. But neither triangular trade nor tourists have produced a satisfactory condition of trade even from America's point of view; for even American exports to Europe have not expanded in anything like the ratio in which America's general economic life has developed.

Again, it may be suggested that America can in fact develop her sales to her greatest market without buying in return by lending capital freely; and that in fact a growing stream of export would merely be the expansion of her capital. Perhaps to some extent that is what has happened in the last two or three years, but can we assume that it will continue? I do not know how many people realize that last year, according to Mr. Hoover's estimates, America's net capital exports only amounted to \$13,000,000; in fact, there was practically no margin of capital export. It is true that on the stock exchange here in New York a record number of foreign securities were floated, but they did not represent a net export because they were paid for, or balanced by capital movements in the opposite direction, by sinking-fund operations on old loans, by purchases of American securities by foreigners, by sales back to London and to other foreign centers, and finally by the influx into the United States of a very considerable amount of short-term money. The net result is that net outflow was, as I say, only \$13,000,000.¹ The United States is

¹ It is of interest to compare the "net" export of capital of Britain and the United States respectively during the last seven years. The figures are the final balance of visible and invisible items of import and export of the two countries according to the Department of Commerce and the Board of Trade respectively. If the figures are correct, it is a mathematical certainty that they must equal the ebb or flow of capital. A surplus export of capital is represented by + and an import by -. The British figures are roughly converted at \$5 to the £1. The margin in favor of Britain should be slightly

doing exactly what we are doing in Britain, namely, borrowing short and lending long. I make no forecast or prognostication. I merely call attention to this fact as indication that it is not at all certain that the United States—with vast uses at home for her annual savings and a very high standard of consumption which puts an effective check on the rate of capital accumulation—has a true margin for capital export at all. If America wants to regain her export position in her greatest market, there is a simple method of doing it, and that is by increasing direct exchanges.

But I must return to my argument. In these circumstances, with trade between Europe and America stagnant and American competition keenly felt in every country in the world, it is going to be very difficult indeed to persuade the countries of Europe to adopt the British solution of a general lowering of tariff, if there is no corresponding move in the United States. It would be extraordinarily difficult politically for any such movement to be carried very far. I think, myself, it will go some way. I think the results of the Geneva Conference will be substantial in certain directions, in simplification in certain cases and in certain cases in lowering duties, whatever may be done on this side of the Atlantic. But it is very difficult to anticipate a substantial general reduction of tariff levels so long as there is in this great United States market one of the highest tariffs in the world. It is as impossible to dissociate the position of the United States—so great has your position in the world become—from this problem as it is to dissociate it from the analogous and very important problem of disarmament.

It is quite inappropriate for any outsider to comment further

reduced to allow for the depreciation of the pound sterling between 1921 and 1924.

(FIGURES IN MILLION DOLLARS)

1920	+2017	+1260
1921	+561	+(875)
1922	+130	+770
1923	-228	+765
1924	+310	+430
1925	+429	+320
1926	+13	-60
	<hr/>	<hr/>
	+3,232	+4,310
	[961]	

on your policy. I have no doubt that your statesmen will consider carefully not only your own internal position but the world position. Again quoting Mr. Harding's message, he says in the same place that "We do not seek a selfish aloofness and we could not profit by it were it possible." If that is to be the keynote of America's economic policy, it should be possible to find the solution of this difficult question and to move along in the right direction the very promising change of opinion which has been revealed at Geneva. Mr. Jeremiah Smith, who is to speak after me, is to sit on the Finance Committee of the League of Nations. I sincerely hope that a United States representative will sit on the economic organization of the League which is to consider this problem of the tariff relations of the world, and that his cooperation will help to fulfil the hope of the Conference that it should in some way "mark the beginning of a new era, during which international commerce will successively overcome all obstacles in its path and resume that general upward movement which is at once the sign of the world's economic health and the necessary condition for the development of civilization."

[962]

WORLD TRADE AND PEACE

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I HARDLY need remind this audience that trade is absolutely dependent upon peace. Trade and commerce recognize it; big business men, even international bankers, whatever they may be and whoever they may be, also recognize it. You read in the papers from time to time that "big business" wants war; that it makes a profit out of it, and that it promotes it. I am neither a business man nor a banker, so I am in a position to judge that question impartially. What capital wants is *security*. It is perfectly willing to work on a reasonable margin of profit, if it is going to be allowed to carry on its operations undisturbed, and it wants that more than anything else in the world. You will always find in every country a few people who like to take risks; who are willing to take risks and to have disturbed conditions exist in order that they may profit by speculation, but taken by and large, big business is dependent upon peace.

Now what is the best way to preserve the peace of the world? That is important not only for business but for many other reasons. H. G. Wells, who is always an interesting writer, whether you agree with him or not, said that people are bored by peace talk. Maybe that is true. There is a great deal of it, however, in the United States. There are at present something like seventy-five different peace societies. I am a trustee of one of them, myself. Every time there is a meeting of any religious organization or of almost any kind of an organization, the convention winds up by passing peace resolutions, which are as thick in this country as blueberries are in Maine in August, but nothing is done; it is all talk and no action.

I am going to give you some of my views on this subject. You may not like them; they are somewhat unorthodox, and a good many people perhaps wouldn't agree with them.

I want to say at the beginning that I am neither a pacifist nor an internationalist. There are times when a man has to fight, or when a country has to fight. It isn't true that it takes two to make a fight. It only takes one. Any drunken stevedore, armed with a pickax, can break into any house in New York tonight, and if he is in an ugly enough temper, he can create a situation where the people in that house will have to fight to protect their lives.. There are countries which can get into the same frame of mind and can do the same thing, and there are occasions when people will have to fight.

I am also a believer in patriotism. That is one of the finest and noblest sentiments that there is—if it is not misdirected—and I know of nothing finer nor better that a man can do than to make some sacrifice for his own country. But a man doesn't have to be either a pacifist or an internationalist to believe that the preservation of peace is one of the most important questions confronting the world today, not only for the benefit of trade and commerce, but for everything that we hold dear.

I have had a fairly good opportunity in the last dozen years to observe the manner in which international dealings are conducted. I have never occupied a prominent part; I have never directed the policy of any government; I have never held any position in my own government in connection with it, but I have had very fair opportunities for observation, and as a result of them I think I can see some of the causes of what happened in 1913.

Most Americans who had anything to do with the negotiations which culminated in the Treaty of Versailles got their first experience with the manner and methods in which international affairs are conducted. I don't think it is an exaggeration to say that it came as a great shock to most of them. We may have been innocents abroad, to have believed that those dealings were going to be conducted openly, with sincerity and with frankness. We may have been rather simple-minded to have believed that some of our Allies meant what they said, when they were talking about the aims of the war or abusing the United States for not getting into it; but what we actually encountered was a very great shock. Now I don't want to be understood as taking the very offensive attitude which some of our fellow citizens do take occasionally, of moral superiority

to Europe. At Paris, the United States was not under any temptation: nobody had anything that the United States wanted. It had no neighbors more powerful than itself, with whom it had a long-standing quarrel. We have been engaged in settling an unsettled country. We have had enough to occupy us in doing that, and I don't know what the United States would have done if it had been subject to the same temptations that some of the other parties to the Conference were subject to. I hope that it would have behaved decently, but you can't tell.

I am not proclaiming any moral superiority over Europe, but you may think what I have said is rather harsh. It is no harsher than what has been said by very many eminent gentlemen in some of the other countries that had anything to do with that treaty.

I came home, exclaiming loudly, "George Washington was right; keep out of wicked, old Europe"; but I began to think about it, and after I cooled off, I came to the conclusion that nobody over there was very much to blame. It was simply what H. G. Wells calls "the Great Power system" in practical operation. These people were doing what had been done for centuries. Macaulay said, I think, speaking of Warren Hastings, that no man should be condemned for not being in advance of the morality of his time. Well, no nation should be, and on reflection I blame no one, I blame no country, I blame no set of statesmen for what happened there. It was practically inevitable, considering the manner in which international affairs had been conducted in the past, that they should be conducted again in the same way. It was too much to expect that overnight they would turn a somersault and come up facing in the other direction.

That, in my opinion, is the real trouble with—the whole crux of—the peace situation. There has never been any standard of international morality in international dealings; and there has got to be created a new sentiment which will insist on the same standards of international morality in international dealings that men of high character use in settling disputes among themselves.

If you can't bring that about, it is only a question of time when there will be another war, on the same general scale as

the last one. We can see now, I think, that Mr. Wilson was not to blame for the Peace Treaty. I do think perhaps if he had been a more skillful negotiator, he might have gotten a little better treaty, but no one man and no one country could, in a few weeks or even in a few months or a few years, overturn a system which had been in practical operation for years, for generations, and even for centuries.

Now what is the remedy? The only remedy for creating a new standard of international morality is by creating some form of public opinion. Of course, there are cynics who say you can't do it; that the world has always been like that and it will always be like that, and affairs will always be conducted on that basis.. I am just enough of a simpleton not to believe them. I think you can have some improvement. I will give you an illustration from the subject of intercollegiate athletics.

I was very much interested in intercollegiate athletics when I was at college, which was longer ago than I like to think; and at that time the affairs of intercollegiate athletics were conducted about on the same basis as a good many foreign offices have conducted their international dealings.

Some of you may be golfers, and those of you who are not can appreciate this, I think. Some twenty-five years ago there was a golf match going on between the representatives of two eastern colleges, and one of the players lost his ball. He had five minutes to hunt for it. He hunted for it and couldn't find it. He went to his opponent and said, "Time's up. It's your hole." Thereupon his opponent, who was a perfectly decent chap, came to him and said, "Here is your ball. I have known where it was all along and of course if I had been playing for myself I would have shown it to you, but I couldn't because I was playing for my college."

That is the way many of these international dealings have been conducted. Now that thing couldn't happen in an intercollegiate golf match today in any part of the United States, because public opinion is against it; and I think if you can improve small things like intercollegiate athletics, it may even be possible to improve large things like the manner in which international disputes are settled.

What is the best of the remedies? In a brief address of

this kind I can't hope to deal, except in a most superficial manner, with all the remedies, but there are quite a number of them. Resolutions are suggested, the outlawing of war, codes of international law, and the establishment of courts for the enforcement of the laws. The Ambassador to the Court of St. James made a most interesting suggestion last June, that a plebiscite should be taken among the self-governing countries to determine whether they should go to war or not.

I do not believe, myself, that any of those remedies are going to accomplish what the authors of them hope to accomplish. Resolutions won't do much good; codes and courts won't do much good. Those people have put on the third act first. Only when you have got some sort of public opinion, will you have laws and courts to enforce them. What abolished dueling as a means of settling private quarrels? It wasn't laws. They had the most ferocious laws against dueling, with double rows of teeth in them, long before dueling was abolished, but it went on. What abolished it finally was public opinion. And I think when you have got the public opinion it will have that same effect. You may have codes and the courts to enforce them, but you have begun at the wrong end establishing codes first.

The great difficulty, to my mind, is that these remedies do not provide the real way in which something can be done, and that is by personal discussion and negotiation. Take our dispute with Mexico, for example. That has been going on for a good many years—seven years and more, to my knowledge. All that time, until very recently, an attempt was made to settle it by a series of diplomatic notes, in which of course neither side conceded anything. In all that length of time there have been just two advances made, two things settled in our disputes with Mexico, and they were settled by personal negotiation in each instance. I don't believe there is any adequate substitute for personal negotiation in settling disputes.

You all know that I have been an officer of the League of Nations; I am not now, though I am serving on a Committee of it, or about to serve on a Committee of it. But I am not serving in any sense as representing my country or representing any interest in it. It is only as an individual that I am serving.

But I have had a very good opportunity to observe the League in action. That is the most ambitious attempt that is being made to produce some solution of this question.

I can tell you a little something about it. The great value of the League of Nations, to my mind, is the publicity which it affords. It doesn't make any difference what is written in the so-called Covenant. I don't much care what is there, beyond one provision, and that is that you agree not to go to war with anybody else until you have thrashed the question out publicly before the League of Nations; and then if you can't agree, you can go to war if you want to. Publicity is a great remedy. It is very difficult to be a mean man in public. It is a great preventive of outrageous claims which were frequently put forward by the foreign offices. I have, myself, seen representatives of various countries walking up and down the corridors in Geneva, before they went into a Council meeting, telling other people what they were going to say about other countries and what they were going to do to them when they got in there. Then I have seen them get in there and look around the room and see there were a good many people there, and when they did say something, it wasn't nearly as ferocious or blood-thirsty as what they had said they were going to say before they went in.

If you are doing business in a glass house, with the rest of the world looking on, it is pretty difficult to get away with many of the things which used to be gotten away with when they were done in dark corners. I think that this is the chief value behind the League of Nations: that you have a place, if you have a complaint against anybody else, where you can advance it. If the other man has a good answer to it, he can get up and give it. You have a good many people there watching you; they are sitting on the side lines; many of them are impartial and disinterested, and it is almost impossible for many of the games that used to be worked, to be worked out in broad daylight.

I will give you an example of what I mean. Perhaps a year and a half ago the Greeks and the Bulgarians got into a terrific dispute. The Greeks got over into Bulgarian territory and the Bulgarians got over into Greek territory, or at any rate the Greeks claimed they did and they commenced to shoot

at one another, and some people were killed. The Council of the League of Nations immediately called a meeting and representatives of both of those nations appeared before it in Paris. The Council of the League said, "Gentlemen, you have each signed an agreement not to go over into the other fellow's territory." Each of them arose and said, "He started it, and I had to do it as a reprisal against him."

The Council said, "It doesn't make any difference who began it. We can send down neutral people who can report and tell us who is to blame, and whoever is to blame will have to pay for it. But the most important thing is that you should each get back behind your own frontiers where you belong and where you agreed to stay. It is our opinion that within twenty-four hours you should each issue orders to your forces to retire behind your own frontiers; and within forty-eight hours those are to be carried out. We will send a Swedish General, or some neutral official, down there to see that that is done. Now do you gentlemen accept that?"

The representative of one of these countries got up and accepted it, and the representative of the other country was asked whether he accepted it. He got up; he was a diplomat; he had been sent there as one of the diplomatic representatives of his country in western Europe, and he had been sent there without any instructions, probably purposely, so that he could say that he had no authority to agree to anything.

He got to his feet and looked in front of him and saw the representatives of eleven different countries sitting there, none of whom, fortunately, had the slightest interest in this dispute, and he looked over his shoulder behind him and saw seventy newspaper reporters with pencils all ready to write down what he was going to say and telegraph his statements to their newspapers. He looked farther back in the room and saw some of the public who had been admitted to the proceedings. He couldn't say that he wouldn't accept it because that was almost equivalent to a declaration of war and was going to be telegraphed all over the world immediately, and, being an intelligent man and not wishing to lose his official head, he said, "Well, that is satisfactory to me, personally, but I don't know whether it will be to my government."

They said, "Well, you can find out by tomorrow. There

are plenty of telegraph lines and you can find out by tomorrow whether that is satisfactory to your government, and suppose you come back tomorrow and tell us."

The next day he was back there and said that it was satisfactory to his government, which was the end of the whole incident—just the kind of an incident that fifteen or twenty years ago would have upset everything in the world and might have got all sorts of powers in on each side of the question.

I don't mean to say that you can settle a dispute between two of the great powers in the world by any such methods as that, before the League of Nations; I am quite sure you couldn't. But if a man is obliged to get up, state his case, make his complaint, there is a lot of time which goes on, there is a great deal of delay and postponement, and the longer that sort of thing continues, with everybody pulling the coat-tails of both contestants, urging for a settlement, the less likely you are to have war. That is what I mean by the value of open discussion in public and personal negotiation.

I wouldn't for a minute suggest that the United States should join the League of Nations if I thought that it involved the dangers which the opponents of the League say it does. But I don't. I think they are very largely imaginary. I don't want to send United States troops to Europe to fight over European boundary quarrels; I don't think this country ought to get into any European entanglements, but joining the League doesn't necessarily mean that. I have seen the Japanese sitting on the Council of the League for seven years, and they haven't gotten involved in any European entanglements; and they haven't the slightest intention of getting involved in any European entanglements, either. You can get involved in them, or not, just as you like.

There are things that the United States wouldn't like if it were a member of the League of Nations. I dare say it wouldn't like to get up and debate questions of some of its policies in Central and South America before the Council of the League. I am not criticizing our State Department for the policies that it has pursued in that respect. As a general rule I think the United States has a pretty good case in most of those instances and I don't think there is any reason why we

should be afraid to state it. I think it probably would result, in the end, in the establishment of a good deal better relations with some of our neighbors than now exist, if there were a place where everybody could go and blow off steam.

Of course I know that it is a political impossibility for the United States to join the League of Nations at the present time. One of our great political parties—and it is the party which has a majority in this country under normal conditions—has persuaded the average voter that there is some danger in this thing, that it is a sort of conspiracy on the part of wicked, old Europe to get Uncle Sam over there and perhaps go through his clothes, or at any rate do something disagreeable to him, and I wouldn't like to see the United States make an attempt to join the League of Nations in the present state of public opinion in the country. I think that public opinion in this country has to change a great deal before it can do it. But I am satisfied, from what I have seen of it, that there will have to be a radical change in the method, the manner and spirit in which international affairs are conducted, if there is to be any improvement, and that the League affords the best chance of bringing this about.

This question is one of the most important questions facing the world today. It isn't going to be settled by rhetoric or by emotion or sentiment. It isn't going to be settled by anything like legalistic formulae. It has got to be settled by some straight thinking by clear-headed people, on a very important subject; and if I have induced, by what I have said, any one of you to think on these things, I shall be perfectly satisfied.

The present period of exhaustion in Europe, following the Great War, is probably the most favorable opportunity that the world has seen to establish a new method of conducting international disputes. If no advantage is taken of it, we shall all be back where we were in 1913; and you all know what that means.

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PROCEEDINGS
OF THE
ACADEMY OF POLITICAL SCIENCE

Volume XIII]

JUNE, 1928

[Number 1

FACT-FINDING IN LABOR DISPUTES

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE SEMI-ANNUAL
MEETING OF THE ACADEMY OF POLITICAL SCIENCE IN THE
CITY OF NEW YORK, APRIL 11, 1928

EDITED BY
PARKER THOMAS MOON

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1928

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PREFACE

IN this volume are published the addresses and papers presented at the Semi-Annual Meeting (Forty-Eighth Year) of the Academy of Political Science, on April 11, 1928, at the Hotel Astor, New York City.

Considering that a timely and valuable public service might be rendered by the Academy through a discussion of certain legal and economic aspects of the labor problem by experts and by spokesmen of the various interests concerned, the Committee on Program and Arrangements formulated a program centering around the basic problem of "Fact-finding in Labor Disputes". The Morning Session was devoted to a series of addresses, followed by discussion from the floor, on the use of injunctions and the rôle of the courts in labor disputes and on the various fact-finding agencies, governmental and voluntary, which have endeavored to clarify industrial conflicts by means of investigation. At the Afternoon Session the topic of "Trade Union and Employee Representation Plans" was discussed from many different angles by representatives of capital, of management, and of labor, and by distinguished economists. At the Dinner Session a large and representative audience heard five able addresses on "Present Needs in Industry". The program of the three Sessions, in detail, was as follows:

PROGRAM

FIRST SESSION

Wednesday, April 11, 1928, 10 A.M.

North Ball Room, Hotel Astor

TOPIC: Courts or Voluntary Agencies

GEORGE ROBERTS, *Presiding*

1. *Introductory Address.* GEORGE ROBERTS.
2. *Fact-finding in the Coal Industry.* EDWARD T. DEVINE.

3. *The Supreme Court's Control Over the Use of Injunctions in Labor Disputes.* THOMAS REED POWELL.
 4. *Industrial Fact-finding as a Function of Government.* RICHARD H. LANSBURGH.
 5. *What Has Been Done by British Fact-finding Bodies in Industrial Relations.* JOHN H. RICHARDSON.
 6. *The Future of Injunctions in Labor Disputes.* T. YEOMAN WILLIAMS.
 7. *Discussion* (under the ten-minute rule). MORRIS HILLQUIT.
 8. *Discussion* (under the five-minute rule).
- Paper read by title: *The Use of Impartial Machinery in Labor Disputes.* RUSH C. BUTLER.

SECOND SESSION

Wednesday, April 11, 2:30 P.M.

North Ball Room, Hotel Astor

TOPIC : Trade Union and Employee Representation Plans

HENRY R. SEAGER, *Presiding*

1. *Introductory Address.* HENRY R. SEAGER.
2. *Employee Representation: A Warning to Both Employers and Unions.* WILLIAM M. LEISERSON.
3. *Our Experiences with Employee Representation.* HARVEY G. ELLERD.
4. *Union-Management Cooperation in the Railroad Industry.* OTTO S. BEYER, JR.
5. *The Trade Union Attitude Toward Fact-finding Bodies.* K. C. ADAMS.
6. *Discussion* (under the ten-minute rule). HERMAN OLIPHANT. HENRY S. DENNISON.
7. *Discussion* (under the five-minute rule).

THIRD SESSION

SEMI-ANNUAL DINNER MEETING

Wednesday, April 11, 7 P.M.

Grand Ball Room, Hotel Astor

TOPIC : Present Needs in Industry***SPEAKERS***HALEY FISKE, *Presiding*

RUSH C. BUTLER

B. SEEBOHM ROWNTREE

FELIX FRANKFURTER

DONALD R. RICHBERG

The following brief "Who's Who" of the speakers who participated in the meeting and whose contributions are published in this volume may serve the convenience of readers, despite the brevity required by limitations of space. The names are arranged in alphabetical order, rather than according to the sequence of speakers on the program.

K. C. ADAMS, whose address at the Afternoon Session presented "The Trade Union Attitude Toward Fact-finding Bodies" (see pp. 128-138), is Director of Research for the United Mine Workers of America.

OTTO S. BEYER, JR., whose address on "Union-Management Cooperation in the Railroad Industry" (see pp. 120-127) was a feature of the Afternoon Session, is consulting engineer for the Standard Railroad Unions and was personally active in the inauguration of the employee representation plan on the Baltimore and Ohio Railroad.

WARREN S. BLAUVELT, of the Hudson Valley Coke and Coal Products Corporation, Troy, N. Y., contributed to the discussion at the Afternoon Session (see pp. 147-148).

RUSH C. BUTLER, senior member of the law firm of Butler, Lamb, Foster and Pope, was retained by the Interstate Commerce Commission during the years 1908 to 1914 to represent

the public interest in the investigation of relations between coal-carrying railroads and coal operators under the terms of the Tillman-Gillespie resolution. Mr. Butler is President of the Illinois State Bar Association and Chairman of the American Bar Association's Committee on Commerce. At the Dinner Session Mr. Butler delivered an address on anti-trust legislation (see pp. 156-161); he also contributes to this volume a paper, read by title at the Morning Session, on the subject of "Industrial Arbitration" (see pp. 178-184).

STUART CHASE, who took part in the discussion at the Afternoon Session (see pp. 145-147), was a partner of Harvey S. Chase and Company, certified public accountants, in Boston until 1917; during the ensuing five years he was occupied with the investigation of the meat-packing industry under the Federal Trade Commission; and since 1922 he has been with the Labor Bureau. He is the author of *The Tragedy of Waste* and joint author of a widely read volume entitled *Your Money's Worth*.

JULIUS HENRY COHEN, who participated in the discussion at the Morning Session (see pp. 88-89), is a member of the law firm of Cohen, Gutman and Richter, of New York City, and author of several important books on legal and labor problems, notably: *Law and Order in Industry* (1916); *The Law—Business or Profession* (1916); *The League to Enforce Industrial Peace* (1917); *Commercial Arbitration and the Law* (1918); and *American Labor Policy* (1919).

HENRY S. DENNISON, President of the Dennison Manufacturing Company of Framingham, Mass., is a distinguished pioneer in matters of industrial management and employee representation. Mr. Dennison participated in the discussion at the Afternoon Session (see pp. 141-144).

EDWARD T. DEVINE, Dean of the Graduate School of the American University, addressed the Morning Session on the problem of "Fact-finding in the Coal Industry" (see pp. 5-13). Dr. Devine served on the United States Coal Commission of 1922-1923; he is the author of *Coal—Economic Problems of the Mining, Marketing, and Consumption of*

Anthracite and Soft Coal in the United States (1925), and has remained in close contact with the situation in the coal industry. For many years Dr. Devine was editor, and subsequently associate editor, of *The Survey*; he was Professor of Social Economy at Columbia University from 1905 to 1919, Director of the New York School of Philanthropy from 1904 to 1907 and from 1912 to 1917, General Secretary of the Charity Organization Society of New York from 1896 to 1912 and Secretary of the same society from 1912 to 1917. During the war he had charge of the Bureau of Refugees and Relief under the American Red Cross Commission to France.

HARVEY G. ELLERD, of the Personnel Department of Armour and Company, recounted the experiences which led to the establishment of the Conference Board system of employee representation in the Armour plant (see pp. 110-119).

HALEY FISKE, President of the Metropolitan Life Insurance Company since 1919 and director of the Chatham and Phenix National Bank and Trust Company, of the Victor Chemical Works, and of the National Surety Company, was the presiding officer at the Dinner Session. A summary of his address is found on pp. 151-155.

FELIX FRANKFURTER, Professor of Law at the Harvard Law School, addressed the Dinner Session on the "Present Needs in Industry" (see pp. 171-177). Professor Frankfurter is the author of *Cases under the Interstate Commerce Act* (1922), *The Oregon Hours of Labor Case*, and *District of Columbia Minimum Wage Cases* (1923), and of numerous contributions to reviews. During the war period Mr. Frankfurter served as assistant to the Secretary of War, secretary and counsel to the President's mediation commission, assistant to the Secretary of Labor, and Chairman of the War Labor Policies Board.

MORRIS HILLQUIT, who led the discussion at the conclusion of the Morning Session (see pp. 84-87), has been engaged in the practice of law in New York since 1893 and was the Socialist candidate for mayor of New York City in 1917. Mr. Hillquit is a member of the National Executive Committee of

the Socialist Party and has been a delegate to several Socialist national conventions and international congresses.

RICHARD H. LANSBURGH, who contributed a paper on "Industrial Fact-finding as a Function of Government" (see pp. 14-19), was formerly Secretary of Labor and Industry of the Commonwealth of Pennsylvania and is now Professor of Industry at the University of Pennsylvania.

WILLIAM L. LEISERSON, Professor of Economics at Antioch College and Chairman of the Board of Arbitration of the Men's Clothing Industry of New York from 1921 to 1923 and of Chicago since 1923, has drawn from practical experience as well as from academic study in preparing his discussion of the challenging topic, "Employee Representation — A Warning to Both Employers and Unions" (see pp. 96-109).

THOMAS REED POWELL, who contributes to this volume a trenchant and documented study of "The Supreme Court's Control over the Issue of Injunctions in Labor Disputes" (see pp. 37-77), is a distinguished specialist on the Supreme Court's decisions. Mr. Powell was formerly Ruggles Professor of Constitutional Law at Columbia University; since 1925 he has been Professor of Law at the Harvard Law School. He has been a frequent contributor to the *Political Science Quarterly*, of which he served as Managing Editor from 1913 to 1916, and to legal periodicals.

MURRAY T. QUIGG, who participated in the discussion at the Morning Session (see pp. 87-88), is the Editor of *Law and Labor*, the organ of the League for Industrial Rights, with offices at 165 Broadway, New York City.

JOHN A. RICHARDSON, a distinguished British economist on the staff of the International Labour Organization at Geneva, came to the United States this year to serve at Columbia University as Visiting Professor of Social Legislation. His address at the Morning Session presented a comprehensive analysis of "What Has Been Done by British Fact-finding Bodies in Industrial Relations" (see pp. 20-34).

DONALD RICHBERG has practised law at Chicago since 1904 and has acted as special counsel for the City of Chicago in gas litigation since 1915, as chief counsel for the railroad unions in the government injunction suit of 1922, and as general counsel for the National Conference on the Valuation of Railroads since 1923. As counsel for the railroad unions he has been actively and intimately concerned with the problems confronting the labor movement. He is the author of *The Shadow Men* (1911), *In the Dark* (1912), *Who Wins in November?* (1916), *A Man of Purpose* (1922), and of numerous articles contributed to magazines and reviews. His witty and yet by no means mainly whimsical address at the Dinner Session expounded the philosophy of "Mutualism" as a remedy for the evils of the existing industrial order (see pp. 185-194).

GEORGE ROBERTS, Chairman of the Committee on Program and Arrangements for this meeting, and presiding officer at the Morning Session, is a member of the law firm of Winthrop, Stimson, Putnam and Roberts, with offices at 32 Liberty Street, New York City.

B. SEEBOHM ROWNTREE, Chairman of the Rowntree Cocoa Works, is an eminent British industrialist and a member of the British Liberal Industrial Inquiry which has recently been engaged in formulating a notable program of industrial reconstruction. As a statesman of industry, coupling a courageous vision with the practical experience of a responsible man of affairs, Mr. Rowntree has a very large number of warm admirers and friends in America as well as in Great Britain. Mr. Rowntree's address on the topic "A Liberal Industrial Policy" was an outstanding feature of the Dinner Session (see pp. 162-170).

HENRY R. SEAGER, Professor of Political Economy at Columbia University and a Trustee of the Academy of Political Science, is an authoritative specialist on labor problems who needs no introduction to readers of these pages. Professor Seager acted as presiding officer at the Afternoon Session (see pp. 93-95).

T. YEOMAN WILLIAMS, who addressed the Morning Session on the topic "Future Injunctions and Labor Disputes" is the Secretary of the League for Industrial Rights (see pp. 78-83).

To the group of distinguished speakers who participated in the Meeting, and whose contributions give this volume its value, the most sincere gratitude and appreciation are due. The officers of the Academy likewise wish to express their indebtedness to the Committee on Program and Arrangements, whose advice and suggestions were of inestimable value in the formulation of a well-balanced program on so many-sided and controversial a subject as the one under consideration. The membership of the Committee was as follows:

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PART I
FACT-FINDING—BY GOVERNMENTAL OR
VOLUNTARY AGENCIES

FACT-FINDING IN LABOR DISPUTES¹

GEORGE ROBERTS

AT first blush it might seem that a discussion of the relations between capital and labor must necessarily be hackneyed, for disputes between capital and labor have existed since civilization began. Certain recent industrial developments, however, lend an unusual degree of significance and timely interest to the topic selected for discussion at this meeting of the Academy of Political Science.

One of these developments is the astounding increase in mass production that has taken place in this country. The Department of Labor recently published a table showing the increase in labor productivity in ten important industries over the period from 1914 to 1925. For rubber tires the increase was 211 per cent; for automobiles, 172 per cent; for petroleum, 83 per cent; for cement, 61 per cent; for iron and steel, 59 per cent; for flour milling, 40 per cent; for paper and pulp, 34 per cent; for sugar refining, 28 per cent; for meat packing, 27 per cent, and for leather tanning, 26 per cent. Other industries show the same trend. In other words, labor-saving devices enable the worker to produce considerably more than he did a few years ago. As a result, the necessary goods are produced by fewer laborers and the laborers so displaced have had to find employment elsewhere.

But perhaps the most remarkable thing in our economic development has been the attitude of organized labor. In Europe organized labor is organized in political parties favoring all sorts of paternalistic and socialistic legislation. In this country, in spite of occasional exceedingly bitter fights, which have almost degenerated into open warfare between capital and labor, as a general thing peace has been recognized as the normal condition of industry, and not infrequently the

¹ Introductory Address delivered by Mr. Roberts as Presiding Officer at the First Session of the Semi-Annual Meeting of the Academy of Political Science, April 11, 1928.

utterances of outstanding labor leaders have been in accord with those of leading capitalists. For instance, Mr. Green, President of the American Federation of Labor, in a statement issued in January, 1928, said:

Organized labor in the United States challenges the owners and management of industry to cooperate with it in the establishment and maintenance of sound economic standards and industrial peace. We welcome the opportunity of giving our collective skill, training and technique to the development of industrial and individual efficiency. We believe that American living standards and national prosperity can be fostered only through the maintenance of a high industrial productivity level and a high, and still higher, mass purchasing power.

In other words, capital and labor have united to create the present economic condition.

Unfortunately, in recent months several clouds have appeared upon the horizon. The condition in the coal industry has challenged attention. Then, too, there is the general question of unemployment. The amount of unemployment has been variously estimated from 2,000,000 to 8,000,000, and thinking people have suddenly realized that we have no adequate method of finding out how many unemployed there are, and what we should do about it when we do find out. The fact that the unemployment crisis apparently is passing, that the reports from various industries seem to show an increase in business, which means an increase in employment, has really nothing to do with the fact that we have been shown that we have inadequate statistics and that we have inadequate plans to meet an unemployment crisis. It was in consideration of these facts that the Program Committee of the Academy of Political Science decided to attempt to emphasize the importance of fact-finding in labor disputes, whether those disputes have reached the courts or whether they have not.

FACT-FINDING IN THE COAL INDUSTRY

EDWARD T. DEVINE

Dean of the Graduate School, The American University, Washington, D. C. ;
Member of the U. S. Coal Commission, 1922-23

THE average intelligent citizen is aware that something is amiss in the coal industry of America. It is fairly well known that five years ago a federal fact-finding commission, appointed by authority of an act of Congress, made an extensive report, with recommendations which have not yet been adopted; that in Jacksonville soon afterwards a wage agreement was made between the soft coal operators and the miners, which has broken down because the union coal companies found it difficult to hold their markets in competition with the non-union operators in West Virginia; that chaotic conditions have now for a long time prevailed in western Pennsylvania and Ohio; that sharp conflicts have occurred in Colorado; that the industry is in a bad way in Indiana, Illinois, and other states; and that collective bargaining—the only hope of the miners for security in regard to their wage scale and working conditions—has lost ground seriously, as measured by the relative amounts of union and non-union coal mined and sold.

It has been necessary to raise relief funds for the families of striking and unemployed miners. Courts have been asked to sanction the eviction of miners' families, to make room for those of non-union miners engaged to take their places. Sweeping injunctions have been issued to prevent interference with the operation of the mines and with the use of the property of the companies; and these have in practice interfered with civil liberties guaranteed by the federal and state constitutions, freedom of speech and assembly, even of worship.

The nation's fuel supply, it is true, has not been interrupted or seriously threatened. There has been no coal shortage. The transportation of coal has not been mismanaged as in some earlier crises. But the notoriously short year of the miners has been violently shortened still further; enormous shifts

have occurred in the source of the coal supply; and there is a wide-spread feeling that this shift is not to be attributed solely to the superior quality of the new supplies or to natural geographic or economic advantages, but that favorable freight rates and unfair wage competition have been the fundamental factors in the dislocation.

It is known that the United States Senate, through one of its standing committees, has been holding public hearings on the coal problem for several weeks, in the course of which representatives of the miners have brought grave charges against both coal companies and railroad corporations, and senators have themselves witnessed distressing scenes in the coal regions. Even those who have followed these hearings attentively, however, would hardly feel that they know what the facts are. Large investors have either said definitely (Mr. John D. Rockefeller, Jr. did) or shown by their testimony that they do not know the facts. They trust their officials and employees. Whether coal companies have or have not violated or abrogated agreements which they were morally bound to maintain (the Pittsburgh Coal Company says that they have not done so); whether the coal companies pay more or less than their fair share of the taxes; whether some railroads have destroyed the prosperity of the mines on their own lines by an uncooperative policy of buying elsewhere at cut prices made possible by non-union operation, as Secretary of Labor Davis is reported to have alleged at the American Mining Congress in 1925; and whether the Pennsylvania Railroad and others have abused their power by coercing coal companies to adopt an open shop, anti-union policy — as to such matters, the average citizen, though intelligent, is not so well informed.

Fact-finding in industry is obviously not a monopoly of the government. In the coal industry owners of the coal measures need certain facts as a basis for deciding about royalty contracts; operators need a much wider range of facts as a basis for wage rate and sales prices; miners need facts for wage demands and agreements and for knowing whether it might be advisable to change their occupation; carriers need facts upon which to base freight rates and extension of facilities; and buyers need facts upon which to judge of prices and values, and the possible resort to substitute fuels. It is a fair assumption

tion, until the contrary is established, that such facts as parties directly interested thus require can be obtained from their own experience or from such sources as are usually open to property owners, operators, workers, carriers and consumers in any competitive industry. Naturally those who are large holders of coal properties, large-scale operators, organized miners or extensive consumers, are in a position to obtain and organize their facts more extensively and more accurately than those whose ownership, operations or purchases are on a smaller scale or who, as workers, do not have the benefit of collective bargaining. However, the aggregate amount of fact-finding by the various factors in the industry for such purely practical purposes in the coal industry will, no doubt, compare favorably with that which will be found in other comparable extractive or manufacturing industries. The United Mine Workers of America would not be at a disadvantage in making any new wage scale because of a lack of information as to what the operators could afford to pay. Through their own technical experts they would ordinarily have information, for example, in regard to any new labor-saving machinery which the operators might desire to introduce, and they would be able to carry on the bargaining process without serious handicap of ignorance concerning the actual mining costs. The railroads and other public utility corporations similarly have their facts in regard to the quality and the characteristics of coal offered to them by various producers at various prices.

Nevertheless, such fact-finding within the industry has serious limitations. The coal companies, the railroads and industrial corporations, and the private individuals or estates who have large holdings, may indeed have at their disposal the service of geologists, engineers and accountants, upon whose facts they can rely, but the individual farmer or other landowner under whose land coal is found has no such resources and may have no practicable alternative to the acceptance of whatever may be proposed by the only operator whose workings are sufficiently near and convenient to justify an offer. A small operator may have no system of cost accounting, and even a large operator may be unable to check up his figures by any adequate comparison with other operators. Non-union miners have only their own observation and ex-

perience and that of their immediate fellows to guide them, and the household consumer is equally unprovided with such facts as would enable him to know whether he is paying a fair price for his coal.

The first ground then upon which we may justify a demand for fact-finding is that so far as small owners, operators, buyers and unorganized miners are concerned, even the elementary facts upon which the give and take of commerce, the haggling of the market, is traditionally predicated, are lacking.

The case is, however, somewhat more serious. It is not merely the ordinary costs, sales realizations, and margins of the operator, carrier and dealer which should be known if the competitive economic forces are to operate freely and with mutual advantage to all concerned. It is also essential to know what special prices are made to favored buyers; what secret arrangements are made; what unnecessary costs are involved in favors to insiders, to relatives or perhaps to officials; what ulterior motives influence carriers, coal owners, operators, or union officials in any policies which are crooked though they may appear straightforward. Overhead costs, as well as actual mining costs, need to be known and taken into account if workers and consumers are really to have a square deal. Investments and profits fall, it is true, under different laws from those of costs and margins; but they are of actual interest to those who mine coal and those who use it. The accumulation of a surplus for the purchase of coal lands or the strengthening of the credit of the company may be sound policy in the case of the coal industry as in the case of railroads, but there is no more reason for secrecy in the one case than in the other, and it can not be alleged that there is equal bargaining power unless such facts are accessible to both parties in any bargaining which the industry requires.

It may be said that the situation in all these respects is not appreciably different from that of other industries in which small producers have to compete with large producers. Why may not the small producers unite among themselves if they have the cooperative inclination and capacity? It is open to miners to organize if they want to bargain collectively and to consumers to form cooperative or municipal fuel yards. Here however we strike our first doubts. Is it in fact open to pro-

ducers, miners or consumers to resort to these obviously appropriate measures? Are there unusual and perhaps insuperable obstacles? Have we in the Sherman anti-trust legislation and in other laws as interpreted by the courts interfered with the free play of competition? Do we by our arbitrary, even if historically understandable, separation of federal and state authority complicate the problem for the individual competitor in the coal industry? Do we in all sections guarantee and adequately protect the rights of the miners to organize and to bargain collectively; or do we, by various devices—company towns, “yellow dog” wage contracts, the form of the company house leases, sweeping injunctions in labor disputes, and the perversion of police authority—virtually destroy the theoretical right to organize? Do the policies of the International Mine Workers of America themselves work in that direction by unduly limiting the autonomy of local districts, seeking to compel an unnatural uniformity which amounts to suicide of the union in sections where, if free to bargain locally, it might survive?

The facts about such questions as these are not such as the consumer, miner, or producer can obtain and substantiate from his individual experience; but they are obtainable. They have been obtained and set forth more than once by journalists, by economists, by foundations, by congressional and legislative investigators and by official commissions. No doubt sensationally exaggerated accounts have been given of particular incidents but the sober facts set forth by the United States Fact-Finding Coal Commission in 1923 will disturb any complacent assumption of the free play of economic forces and the adequacy of the competitive principle as a protection either to worker or to consumer. Such facts were obtained on a large scale for a particular year, at considerable expense, and set forth in perhaps overwhelming detail. They could be obtained regularly and set forth clearly at periodic intervals and at a moderate expense just as the facts about production, sales realization, etc., are now obtained and set forth by the Bureau of Mines.

Fact-finding, I repeat, is not a monopoly of government; nor is it a function merely of the individual factors in the industry for the promotion or protection of their own financial

and economic interests. It depends on the nature of the facts desired and the use to which they are to be put, whether they can best be obtained in one way or another. The general principle would seem to be to leave to individual factors—coal owners, operators, carriers, miners and consumers—the responsibility for observing, collecting, interpreting and using such of the facts as are obtainable by direct experience and observation, or by facilities which they can reasonably be expected to create, and which are useful to them; but to recognize that the coal industry is of such basic importance in the national economic organization, and that fuel is so essential in our domestic economy, that supplementary means are necessary to obtain and make available the facts not thus obtainable by individuals.

We may consider in turn what those supplementary means of fact-finding are. The daily press, the weekly journals of general circulation, and the special organs of the coal industry, whether representing operators, miners or consumers, have perhaps first place in any such enumeration. They obtain facts while they are alive, while they have fresh and vital significance. The motive is of course that of all journalism—the news value to subscribers, the income to be obtained by meeting the news demand. It is a legitimate motive. It serves. It leads to heroic reporting in the face of personal danger, to sustained, creditable plans for educating the public on controversial issues. A free press is, I think, the most important single fact-finding agency. Interference with freedom of the press or its corruption is the gravest of all dangers in the coal industry as in any industry. The steady diminution in the number of independent journals, while it makes those which survive more powerful, increases the risk. If all our eggs are in one basket, we certainly need to watch that basket.

There is a place, secondly, for disinterested, public-spirited inquiries, like that which the Federal Council of Christian Churches is now making in the Pittsburgh district, and which I understand will soon be ready for publication. When human life is imperiled, when there is widespread deprivation and hardship in an industrial controversy, when civil liberties are denied and property is destroyed, when feeling runs high, when moral as well as economic issues are involved, and it is

difficult for the private citizens to follow the facts as reported in the press, and to distinguish fact from fiction, there is a clear obligation to devise some plan for an authoritative, unimpeachable, impartial pronouncement, not only on the facts but if possible also on the moral issues, the social policies involved. To say that such a survey and pronouncement must be fair and impartial is not to say that it must be colorless, or infallible. It can not be free from the possibility of human error and it may not even be the last word on all of the facts. The Protestant Churches, acting through their Federal Council, and the Catholic Church, through its National Welfare Conference, while not assuming any such infallible freedom from the possibility of error, for they are not here pronouncing on religious doctrines, on questions of faith or dogma, may render the greatest possible service not only to their respective members but to the public in general. They are and may insist on being regarded as disinterested. They have created special organs for research and education in the field of industry and social relations. They can not be indifferent to lawlessness whether on one side or the other. Human distress, the need of the hungry and shelterless, of strangers and of prisoners, is their historic problem—recognized as such by Mosaic law, by prophecy, by gospel, and by centuries of Christian philanthropy. But business and industrial ethics belong in their domain also. The change of emphasis from a purely personal religion to one which claims jurisdiction over the whole life of man is a return to an ancient and sound conception of the function of religion, as well as a necessary development of the newer understanding of human behavior.

A third method of fact-finding for which there may be legitimate occasion is represented by the recent inquiry undertaken by the Interstate Commerce Committee of the Senate. Either house of Congress, through a special committee or one of its standing committees, may perform a public service by an inquiry which will expose evils and lighten up controversies in a way that is not within the power of any unofficial body. State legislatures may in some situations perform a similar service. Such uncovering of corruption in the government itself and of such scandalous relations between political parties and private interests as have been disclosed by the investiga-

tion of the Public Lands Committee into the oil industry, is not only legitimate but of incalculably far-reaching importance. In that instance further justification for the investigation lay in the fact that the policy of naval oil reserves was involved. While no such overwhelming reasons are to be found in any notorious facts for a congressional or legislative inquiry into the coal industry, at the same time the long-standing division between union and non-union territory, the bitterness of the industrial conflict, and the failure of the coal industry to function continuously in such a way as to insure the nation's fuel supply on the one hand and a reasonable degree of prosperity to the coal industry on the other, give sufficient warrant for legislative inquiry.

It has been a good thing for the senators to visit the scene of the protracted strike. It has done no harm to give operators and representatives of the miners an opportunity to air their views at a public hearing with the resulting newspaper publicity. We are rather more likely to secure the necessary legislation for official fact-finding and the adjustment of industrial difficulties because such hearings have been held. Even if we are skeptical on general principles as to the results of fishing expeditions by legislative committees, we may, nevertheless, recognize that such inquiries may and often do bring something to the surface, even though it may not be the particular aquatic game for which the hook was baited.

These four methods of fact-finding then — (1) by the individual in his own interest; (2) by the public press in public interest; (3) by some disinterested body like the Federal Council in the interest of the social conscience; and (4) legislative inquiry as a basis for remedial legislation — are all legitimate and in connection with the coal industry have ample justification. All together, however, they are not enough. What is needed more than any of these, except the first, is authoritative, disinterested, and continuous fact-finding by the Federal Government through an official agency created for that purpose. This was the conclusion of the fact-finding commission of 1922-23, and so far as governmental action is concerned was the most important of the recommendations of that commission. The need for such fact-finding would remain if the mines were nationalized, but it is equally urgent if the

mines remain under private control and management. No sporadic inquiry by press or church or legislative body can take the place of it.

Through the Bureau of Mines the Government already collects facts in regard to production and sales realization, but the facts in regard to costs and margins, investments and profits, wage rates, and annual earnings, are all likewise essential. The purpose of collecting and disseminating them at stated intervals is not to embarrass but to aid the industry and the consumers of its output. Whether it would be appropriate to make known the facts in regard to a particular corporation engaged in the coal industry, as is now regularly done in the case of railroad corporations, may be a question. Fact-finding and publicity do not necessarily involve this. Facts could be grouped as they are by the Census and the Internal Revenue Bureau in such a way as to avoid making known the costs of any particular operator or buyer, if that is preferred, although personally I would favor following the precedent of the practice in regard to the railroads and accepting literally the principle recognized by the Coal Commission that the time has come when there no longer need be or should be any secrets in the coal industry.

I see no likelihood of any substantial change for the better in the distracted and debilitated coal industry until the recommendations of the Fact-Finding Coal Commission in regard to permanent, continuous, official fact-finding are put into effect.

INDUSTRIAL FACT-FINDING AS A FUNCTION OF GOVERNMENT

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ONE of the most interesting commercial phenomena at the present time is the plea business has been making that government shall not interfere with or guide its operations, while, at the same time, in almost every crisis it demands that government shall give aid. In effect, this means that government is expected to do for business what it cannot do for itself in times of stress, but it shall know nothing about business as a basis for such action. However, a large section of the industrial community has shown no desire, in recent years, to have the government interest itself in one type of industrial problem, and one of the most important, namely employer-employee relations. Although there have been sporadic attempts to foster good employer-employee relations in this country through governmental bodies, such as the Railroad Labor Board, nevertheless such instances have not had the support of both parties within the industry. Union labor has time and again demanded governmental action, but it has not favored governmental arbitration in all cases, and it has feared the effect of data prepared by governmental fact-finding commissions, which, it has respected, have had only some of the facts, or have been prejudiced against it.

The so-called "American" plan of employer-employee relations which has been advanced by certain employing interests in recent years, including as it does the open shop and the entire right of the employer to deal with his workers as he sees fit, in no way provides for industrial fact-finding as a function of government. When the demand arises in Congress, as it did recently, for a survey of an important current industrial condition, unemployment, this same group endeavors to sway the agency making the investigation by news releases without end tending to show that in the industries which they represent the unemployment is only slightly above normal.

The employing group at large has never accepted the result of any investigation made by a government fact-finding body in this country if it did not favor their interests.

Thus, while government assistance in business problems is desired in most instances by business, this does not hold true for assistance in solving labor problems, either by the development of facts or by mediation or arbitration. Such a condition has prevented governmental agencies from asking for grants of power for fact-finding, and, indeed has resulted in failure to utilize grants of power already enjoyed. Thus, although the Interstate Commerce Commission has full power to require the railroads to report conditions of employment, such as wages, in such ways that they will be useful in wage-determination they have maintained their reports in such form that they cannot be used with confidence in time of negotiations. If there were a greater disposition on the part of the railroad companies to present wage statistics in a form that would make them available under such conditions, that is, as the basis of fact-finding, governmental or within the industry, doubtless the reporting forms of the Interstate Commerce Commission would have been changed before this.

When a fact-finding commission, such as the United States Coal Commission, has sought information within an industry, it has been impeded in numerous petty ways, particularly in attempts to secure information from company books. This Commission's work was probably the greatest single attempt at fact-finding in any of our basic industries; yet, whatever the cause, its findings have affected the operation of the industry but little, either in time of industrial warfare or in time of industrial peace. It is significant that the present lamentable conditions in the soft coal industry have followed so closely the work of this Commission. Our businesses pay but passing attention to fact-finding reports of governmental agencies in matters affecting labor relations.

During the last anthracite coal strike, Gifford Pinchot, Governor of Pennsylvania, found difficulty in having the anthracite coal operators meet with him in a mediation attempt, because he had settled a previous controversy along lines dictated by the fact-finding of the United States Coal Commission and by agencies of the Commonwealth of Pennsylvania.

Industrial strength, rather than industrial facts, has been used as the basis of wage-relations in this industry for many years.

These conditions, and the fact that business itself so often demands aid from governmental bodies, bring forward the question as to the function of government in an economic age such as the present. If facts collected by governmental authority are not recognized in disputes which effect whole sections of our country because the facts are not considered accurate, though they have been collected largely from the side which questions them, it is improbable that the government will be able to serve that industrial section with any degree of helpfulness. We have heard that government should be the servant and not the master, but if governmental fact-finding in labor disputes be spurned by those affected, governmental action will be in connection with police power only, which will serve not to adjust the industrial situation, but to intensify it. When exercising its police power a government is most certainly the master.

Facts in industry are becoming more complicated every day. With the development of mechanization in industry, and with the competition that exists under the present buyers' market, facts which can be used as the basis of a wage-settlement are so complicated as to be outside the reach of individual workers or workers' organizations other than the largest and the strongest financially. Trade associations and employers' associations have cost information from their individual members that would serve as the basis of settlement of many wage disputes, and yet these facts are not even given to arbitrators who are called in in times of industrial strife. Relative strength of bargaining power on either side may ruin a community while the facts that would go far to solve the issues are locked up in the safe. If government is not going to take those facts out of the safe, who is? The individual employer is not, the trade association is not, the employees cannot. Huge government departments, with payrolls amounting to many hundreds of thousands of dollars annually, struggle "to promote better understanding between employer and employee", but the facts that would allow them to promote such understanding are locked from them. It is no wonder that their payrolls become the plaything of the politician, to be used in furthering his

own local political interests. For, in exercising the authority which is given them, these governmental agencies dare not deal with facts, for facts might offend some large interests with votes, and votes mean the political life not only of the head of the agency but of the agency itself, and hence the continuation of the payroll.

There are millions of the people's dollars wasted every year on activities that can reach no good end unless basic industrial facts are known, and there are few attempts to reach the facts. And if fact-finding were attempted, the next legislature or Congress would find many members desirous of cutting off the funds of that particular governmental agency. This condition cannot be changed until the attitude of large sections of the people towards governmental fact-finding is changed. Fundamentally, this attitude cannot be changed until the appointees and committees and commissions appointed to find the facts have training which will enable them to know fact from opinion, and will have sufficient personal strength to demand that the facts, as found, be utilized rather than scorned.

Let us pause to observe some of the facts of industry that effective governmental fact-finding might bring to public knowledge:

(1) The causes of the present unemployment situation and the remedies. If mechanization of industry is a major cause of unemployment and hence of a decrease of the community's purchasing power, some neutral agency outside of industry must study the economic conditions of the country and suggest a remedy. That is a natural governmental function. It is apparent that wage decreases and lengthening of hours of work will not ameliorate the present situation but rather aggravate it. Yet such programs are being undertaken by many employers in this country. Suppose that maintenance of wage levels with two shifts to utilize better the production machinery of today is what is needed. I personally feel that would be a bold approach to a solution of the unemployment problem caused by mechanization. Only unbiased investigation could show whether such steps were in fact desirable. University research departments, research foundations and the government provide the only means of such investigation. The findings of the first two types of bodies will not receive

general publicity nor will they enjoy general confidence for many years. Governmental fact-finding might point the way out of the present situation.

(2) The United States Bureau of Labor Statistics has pointed the way in fact-finding on questions of wages, hours, cost of living, and safety. Its researches are utilized to a tremendous degree. Yet there is no machinery established whereby this bureau could bring employers and employees together and lay the facts before them. The Division of Simplified Practice of the United States Department of Commerce under the leadership of Mr. Hoover and Mr. Ray M. Hudson has shown the way in bringing conflicting trade groups together around the conference table to consider the facts that provide the necessary basis for any sound attempt to deal with conditions detrimental to the industry. As indicated, it is easier to accomplish this in such a case than in labor questions, but still it remains true that governmental fact-finding before trouble starts can be an important aid in labor questions. The same technique as in simplification would not work, but a similar technique might.

(3) State departments of labor in industrial states are in constant touch with labor conditions within their states. They are already collecting employment, wage and, in some cases, turnover data. They have mediation services which act in industrial disputes after they occur. In some states, such as Pennsylvania, this service has acted upon information that disputes might occur, and frequently, in such cases, it has been found that better understanding of conditions between employer and employee would serve to eliminate the threatened difficulty. Such services should be greatly enlarged and to their staffs should be added experts in industrial fact-finding. These may serve the mediators by placing them in an excellent position compared to employer and employee with relation to knowledge of facts in a given industry. In some states there is already a close connection between the group collecting wage and employment data and the mediators. Such close connection is very desirable and should be established in state departments in which it is now lacking.

(4) Since government, and government only, is able to develop a fact-finding service that will be of value to the

country at large, it is essential that this fact be recognized by officers in charge of governmental departments and bureaus which might undertake such service. Too many times in the past such officials have apologized to industry for what they themselves termed their "interference". It will be necessary to change industry's viewpoint and that will never be done by apologies for the governmental unit involved. However, in order that no apologies may be necessary, the character of personnel in all governmental fact-finding groups must reach the standard set today by those which are not involved in partisan politics. To bring such politics into industrial disputes ends the value of the so-called fact-finding group.

In conclusion it is evident that industry is opposed today to governmental fact-finding in labor disputes and that this circumstance has hampered any steps that have been taken in the past. However, it is also evident not only that fact-finding is a governmental function, but that the government is the only possible agency for effective, neutral fact-finding in industry. Furthermore, it is probable that if a governmental group believes in itself as a fact-finding agency, it will have a fair chance of success.

NOTE. In the discussion which followed Professor Lansburgh's address, Mr. ROBERTS said: "I cannot help remarking that in my opinion the attitude of industry is not quite so bad as Professor Lansburgh has said. While everything he has said may be true, certainly there is a tendency among employers and industry in general to favor fact-finding much more than in the past. For instance, in the case of the Coal Commission, on which Dr. Devine served, I happen to know that the Bituminous Committee, acting on the advice of their counsel, opened up all their books. Again, in the recent investigation of the General Electric Company by the Federal Trade Commission, the General Electric Company opened up its books. In the present investigation of the public utility industry by the Federal Trade Commission, I know that counsel have advised, and I believe that the industry will adopt, the policy of not making any technical objections to the investigation. I simply cite these as a few elements of hope in the situation. Of course I agree entirely with Professor Lansburgh's conclusion that we ought to have more impartial governmental fact-finding in industry."

WHAT HAS BEEN DONE BY BRITISH FACT-FINDING BODIES IN INDUSTRIAL RELATIONS

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RECOGNITION of the contribution which fact-finding can make to improvement of British industrial relations is a recent development. In pre-war days negotiations for the establishment of wages, hours, and other conditions of labor in the leading industries were mainly trials of strength between the employers' and workers' organizations. The facts of the situation were rarely available. Some improvement has been effected in recent years, the protracted post-war depression having convinced both employers and workers of their common interest in the avoiding of disputes. This has resulted in a tendency to replace conflict by cooperation based on joint investigation of the facts, but so far in many industries only the fringe of the problem of fact-finding has been touched.

The need for more complete and systematic information regarding the state of industry is widely expressed by those interested in securing the peaceful settlement of industrial disputes. They recognize that ignorance of the facts frequently leads to exaggerated demands by both sides. On the other hand, adequate knowledge of the situation often proves that the margin in dispute is so narrow as not to be worth a fight.

The case for compiling and publishing the facts is strongly presented in a report prepared in 1926 by an unofficial committee consisting of prominent employers, trade union leaders, economists and statisticians.¹ They were agreed that:

. . . there is no more vital problem for the nation than that of assuaging industrial unrest. Among many causes of our difficulties a leading one is dissatisfaction with the sharing of the product of industry and the feeling that the worker sometimes does not get a fair deal, and at

¹ *The Facts of Industry: The Case for Publicity*, published by Macmillan and Company, London. A number of the examples given in the present paper are taken from this report.

others, owing to lack of knowledge, demands impossibilities. This suspicion can only be allayed by the fullest information, by which we mean not merely facts produced in time of emergency, but a regular watch upon the progress of production and the distribution of the proceeds. We are not optimistic enough to think that the disclosing of information alone will create industrial peace, but we are satisfied that industrial peace cannot be attained without it.

The report of the committee in addition to arguing the importance of publicity gives a survey of the statistics available and makes specific recommendations for their improvement into an effective instrument for industrial peace. The importance of publicity of the facts about industry is also stressed and definite proposals are made in the Report of the recent Liberal Industrial Inquiry.¹

Before proceeding to an account of the extent to which fact-finding has been developed in Great Britain a brief description is given of the machinery by which industrial relations are regulated. It is only on the basis of a knowledge of the machinery in operation that the value of the statistics available for industrial negotiations can be appreciated.

THE MACHINERY OF INDUSTRIAL RELATIONS²

Collective Bargaining. The predominant method by which labor conditions are regulated in all the chief industries is collective bargaining between organizations of employers and of workers. The importance of this method is indicated in part by the fact that, at the present time, the number of trade unionists is about 5,500,000 or approximately one-third of the total number of industrial wage-earners. The employers are equally well organized. It should be borne in mind, also, that the effective field of application of agreements extends considerably beyond the membership of the signatory parties.

Conciliation and Arbitration. Collective bargaining is supplemented by conciliation and arbitration systems set up either by agreement between the organizations of employers and workers themselves, or by legislation. The industries in which

¹ *Britain's Industrial Future, being the Report of the Liberal Industrial Inquiry* (London, 1928), pp. 85-9, 121-5 and 218-9.

² A detailed account of British methods of industrial negotiation is given in the *Survey of Industrial Relations* by the Committee on Industry and Trade (London, 1926).

systems of conciliation or arbitration or both have been set up by agreement include the iron and steel trades, coal mining, engineering, shipbuilding, the cotton trade, the boot and shoe trade and railway transportation.

The system of conciliation and arbitration established by legislation is based entirely on the voluntary principle, there being little demand in Great Britain for compulsory measures. It is mainly embodied in the Industrial Courts Act, 1919.¹ This act provides that, with the consent of parties to a dispute, the Minister of Labor may take such steps as he considers expedient to settle the dispute by conciliation. Where these steps are not effective the Minister may, with the consent of the parties, refer the matters under dispute to the Industrial Court, which is a permanent court of arbitration. If the parties prefer, the dispute may be referred to a single arbitrator or to a Board of Arbitration specially constituted for the purpose. The Industrial Courts Act also gives the Minister of Labor power, especially in cases of dispute in which the interests of the public are involved, to set up Courts of Inquiry, with or without the consent of the parties. These Courts have no power of arbitration; their task is to endeavor to secure relevant data so that the issue may be narrowed and the public provided with an impartial statement of the facts. In practice this system of voluntary conciliation and arbitration has been frequently called into operation; the Industrial Court alone has dealt with over 1000 cases, and its decisions have been almost invariably accepted.

Joint Industrial Councils. Collective bargaining is also supplemented by a second system, namely that of Whitleyism or Joint Industrial Councils. The purpose of this system is to provide means for insuring that the conditions of industry shall be systematically reviewed by those concerned. It represents an attempt to extend the principle of industrial democracy. Instead of occasional conferences for collective bargaining, the scheme is to provide machinery for regular meetings of employers and workers for constructive discussion and cooperation based on mutual recognition of common in-

¹ In addition to the system established by this Act, officers of the Ministry of Labor in the chief industrial centers endeavor to settle disputes by conciliation.

terest in the prosperity of industry. It affords opportunity for the study of problems such as improvements of processes and productive organization, industrial research and the elimination of waste, which are not normally considered in collective bargaining. The councils consist of representatives in equal number of employers' organizations and of trade unions. The system was introduced with enthusiasm immediately after the war with the support and stimulus of the Government, and, although it has suffered a decline more recently, it has made and continues to make an important contribution to the maintenance of good relations in a number of organized industries. At the present time there are nearly fifty Joint Industrial Councils covering industries which employ a total of over three million workers. These national councils are supplemented to some extent by District Committees and Works Committees.

Trade Boards. The systems of collective bargaining, conciliation and arbitration and Joint Industrial Councils outlined above are applicable almost solely in industries in which organizations of employers and workers are well established. There are, however, a number of branches of industry in which no adequate machinery exists for the effective regulation of wages. If in any such branch the rates of wages are exceptionally low the Minister of Labor, in accordance with the provisions of the Trade Boards Acts of 1909 and 1918, may set up a Trade Board for the purpose of fixing minimum wage rates. A Trade Board consists of members representing employers and an equal number of members representing workers, with the addition of impartial members (in practice three). At the present time Trade Boards are established in some forty branches of industry employing about $1\frac{1}{4}$ million workers.¹

All the various bodies for industrial relations described above are concerned with the facts of industry. The extent to which they compile the facts is now indicated. An account is also given of more general industrial fact-finding undertaken by certain government departments and other public and private bodies.

¹ A system of regulating the minimum wages of agricultural workers in England and Wales by means of County Committees and a Central Board is in operation in accordance with the provisions of the Agricultural Wages (Regulation) Act, 1924.

FACT-FINDING BY EMPLOYERS' AND WORKERS' ORGANIZATIONS
IN ORDINARY COLLECTIVE BARGAINING

To an increasing extent both employers' and workers' organizations submit data in collective bargaining. The data compiled are, however, subject to certain defects. They are usually prepared for the purpose of supporting a particular case rather than to give a systematic and impartial review of the actual position of the industry. Consequently they are attacked by the opposite side and tend to generate a distrust of statistics. They are compiled only at irregular intervals and do not give a continuous review of conditions. These defects have been remedied in certain industries by the establishment of machinery for more frequent meetings or by agreements to set up committees of enquiry on which both employers and workers are equally represented. Also the sliding-scale system of wage adjustment which has been widely adopted involves a regular review of the facts on which the scales are based.

The engineering industry provides an illustration of fact-finding by one side in particular collective negotiations. In 1924 the employers presented a detailed statement for about 1000 firms showing total turnover and cost of production including costs of materials, wages, general and administrative charges. The statement was designed to show the smallness of the balance available to meet capital and certain other charges. In negotiations on the railways, data have been submitted by the companies showing changes in receipts and dividends in relation to changes in wages.

Facts Compiled by Joint Committees. Of more value in improving industrial relations are the cases where committees of employers and workers have been set up jointly to investigate the facts. An interesting example of such a committee is that set up in 1925 to consider the position of the shipbuilding industry. Both employers and workers were desirous of cooperating to assist in the recovery of the industry and especially to enable British firms to compete more effectively with German and Dutch companies. Detailed investigations were conducted. An Interim Report, dealing with costs within the control of the industry, was published in October, 1925, and a Final Report, dealing with costs outside the control of the

industry, was published in July, 1926. In the sugar-refining industry at Greenock a dispute in 1924 due to refusal to grant a wage increase was settled as a result of an investigation, agreed upon by both employers and workers, into the financial condition of the industry. The facts, compiled by a firm of chartered accountants, led to the withdrawal of the workers' demands. Another illustration is the Court of Investigation set up by representatives of employers and workers engaged in the Scottish shale oil industry as the result of an agreement of December, 1925, to consider certain matters in dispute. A survey was made of wages, selling prices of the oil products and profits. The facts obtained made an effective contribution to the settlement of the dispute.

Facts Used in Sliding Scale Agreements. The application of the sliding-scale principle has made a notable contribution to the improving of industrial relations. According to this principle the wage scale, instead of being fixed for the whole period of validity of an agreement, is variable in accordance with changes in some specified criterion. The system is applied in a number of important industries in Great Britain, including the chief branches of the iron and steel industry, coal mining, the wool and certain other branches of the textile industry, the boot and shoe trades, transportation, public utility undertakings and the civil service. Although the system makes little contribution to the problem of what basic wages shall be fixed, it is of value in securing the regular adaptation of those wages to changing conditions without the necessity of reconsidering the whole problem at frequent intervals. In this way the period of validity of agreements is prolonged and the possibility of disputes diminished.

The sliding-scale system involves agreement as to the precise facts in relation to which the basic scale shall be adjusted and the methods by which these facts shall be compiled. The most appropriate facts vary from industry to industry. Three main criteria have been adopted in sliding-scale agreements, namely changes in selling price of the product, changes in the proceeds of the industry and changes in the cost of living.

Sliding-scale arrangements based on the selling price of the product have been in operation for many years in the most important branches of the iron and steel industry. They have

greatly facilitated the maintenance of industrial peace, no serious stoppage having occurred since the system was introduced. In the various branches typical products, e.g. pig iron, or steel bars and steel rails, are selected. The average selling price during three months or other specified period is calculated, the data being taken from the books of the various companies by accountants jointly employed by the employers' and workers' organizations. Wage rates during the succeeding period are determined automatically by this average selling price in accordance with the agreed scale of adjustment.

In the coal-mining industry various post-war agreements provide for the regular adjustment of wage rates in accordance with the proceeds of the industry. These agreements, which cover the whole of the industry, have resulted in the compilation and publication of much valuable information required to determine what the proceeds have been during each period of three months, together with supplementary statistics. The data are compiled in each coal-mining district by accountants appointed by Joint Boards on which employers and workers are equally represented. The information is supplied to these accountants by the employers and is checked by test audits. The statistics include quantity of coal produced, costs of production, proceeds from the sale of coal disposable commercially, number of workpeople employed, number of man-shifts worked, average earnings per man-shift worked, and the number of man-shifts lost which could have been worked (including absences due to sickness or accident). These data are available in a continuously comparable series since 1924 and, with certain modifications, since 1921. They cover practically the whole industry and give a detailed review of its position.

The cost-of-living sliding-scale system was widely adopted during the war and in the early post-war years when prices were changing rapidly. With the relative stability of prices in recent years the system has declined somewhat in importance. However, agreements providing that basic wage rates shall be varied from time to time during the validity of the agreements in relation to changes in the cost of living are in operation for about 2½ million workers.¹ In these cases the

¹ The cost-of-living sliding-scale system applies to some of these workers in accordance with Joint Industrial Council agreements or Trade Board determinations.

facts regarding changes in the cost of living are not compiled by the employers and workers; they have adopted instead the cost of living index published each month by the Ministry of Labor.

FACT-FINDING BY VOLUNTARY CONCILIATION AND ARBITRATION MACHINERY

The systems of voluntary conciliation and arbitration established either by agreement between employers' and workers' organizations or by the Industrial Courts Act, 1919, have made important contributions to the peaceful settlement of disputes. The decisions are based on an examination of all the facts forthcoming, and frequently data are secured which otherwise would not be taken into consideration. Thus in a number of cases arbitrators have been given access to the employers' accounts. The Courts of Inquiry under the Act of 1919 have no power to compel the parties concerned to give information, but their requests for evidence have rarely, if ever, been refused. The Industrial Court, dealing with disputes in different industries in all parts of the country, secures much information of a general character. In a particular dispute it is therefore able to base its awards on a wide knowledge of conditions in other trades.

Conciliation and arbitration systems, however, investigate the facts only as a last resort when disputes have become acute. They do not undertake those regular and systematic compilations which are essential if mutual confidence and fair dealing in ordinary negotiations between employers' and workers' organizations are to be developed.

FACT-FINDING BY JOINT INDUSTRIAL COUNCILS

As fact-finding bodies Joint Industrial Councils are more satisfactory than occasional conferences of employers and workers for the purposes of collective bargaining, or than conciliation and arbitration systems. They meet regularly and are established for the purpose of increasing goodwill and mutual understanding. The "model" plan on which most Joint Industrial Councils have been constituted includes among the functions appropriate for these bodies "the collection of statistics and information on matters appertaining to the industry". About three-quarters of the Councils now in operation have incorporated a provision of this character in their constitutions.

In practice only a few Councils appear to be compiling statistics regularly which show in detail the output, costs, profits, capitalization and state of employment for the industry as a whole or for a representative part of the industry. Such data, with detailed subdivisions, have been published in the annual reports of the Joint Industrial Council for the Iron and Steel Wire Manufacturing Industry. The Joint Industrial Council for the Pottery Manufacturing Industry has set up a Statistical and Enquiry Committee which compiles information regarding wages, prices, profits and other relevant data. A significant step was taken in this industry during wage negotiations in 1924 when a firm of chartered accountants was employed to make a detailed inquiry into earnings, selling prices and profits throughout the industry. The facts brought to light by this inquiry were recognized to be of the greatest value in providing the basis for a peaceful settlement, and the desire was expressed that similar information should be compiled at regular intervals for use in wage adjustment.

In several other industries, e.g. match and glove manufacturing, statistics are regularly compiled which give the Joint Industrial Councils information as to the state of trade. The data compiled include statistics of production, imports and exports, and employment. In certain industries which do not compile statistics regularly, facts regarding their financial condition have been furnished during wage negotiations. The supply of this information appears frequently to have facilitated the reaching of a satisfactory settlement. In some cases the facts have been compiled by firms of chartered accountants; this method ensures impartiality and, at the same time, avoids the disclosure to interested persons of the position of the individual firms.

FACT-FINDING BY TRADE BOARDS

Trade Boards, like Joint Industrial Councils, have certain advantages as fact-finding bodies over ordinary conferences for collective bargaining and over conciliation and arbitration systems. They are regularly constituted. They cover the whole branch of the industry in which they have been set up and, in conducting inquiries, can obtain assistance from the Ministry of Labor with its Trade Boards Inspectorate. Hitherto, however, the Boards, when considering what mini-

imum rates of wages to fix, have not generally undertaken systematic inquiries into the facts. As in collective bargaining, the employers when faced with a demand for an increase in rates argue that the rates proposed by the workers are beyond the capacity of industry to pay and often refer to the severity of foreign competition. The workers endeavor to base their claims on the cost of living and denounce the existing rates as starvation wages. But the facts presented in support of the various claims are mainly based on general evidence only.

A number of boards have adopted the sliding-scale system by which the minimum rates are adjusted periodically in accordance with changes in the cost-of-living index compiled by the Ministry of Labor. Occasionally individual employers have submitted to the impartial members of boards statements regarding the financial situation of their businesses. In a few cases boards have requested information as to existing rates of wages or the economic conditions of the industry before deciding what minimum rates to fix. Certain investigations have been conducted into the effects of the minimum rates fixed, and into the earnings which minimum piece rates provide.¹ The results of these investigations have facilitated the work of the various boards, thus indicating the desirability of further developments along similar lines.

FACT-FINDING BY GOVERNMENT DEPARTMENTS OR IN COMPLIANCE WITH CERTAIN STATUTORY REQUIREMENTS

Many of the facts compiled and published by various government departments throw light on the state of industry and are frequently used by employers and workers during collective negotiations.² Certain figures of interest in industrial relations are compiled to meet statutory requirements. Reference is made here only to some of the more important data available.

The Ministry of Labor. Mention has already been made of the extensive use in sliding-scale agreements of the cost-of-living figures published monthly by the Ministry of Labor in

¹ D. Sells, *The British Trade Boards System* (London, 1924), pp. 20, 25.

² A complete statement of the current statistics published by British government departments is given in the *Guide to Current Official Statistics of the United Kingdom* (London, 1926).

its *Labour Gazette*. These figures are also widely quoted during wage negotiations apart altogether from the sliding-scale system. The Ministry publishes each month comprehensive statistics of unemployment compiled in connection with the application of the Unemployment Insurance Acts. They cover over twelve million workpeople in practically every industry except agriculture and domestic service. Separate data are given for each industry and branch and for males and females, showing the numbers wholly unemployed and the numbers involved in temporary stoppages. These figures of unemployment are supplemented by statistics of employment in representative undertakings in some of the principal industries. The Ministry publishes the rates of wages and hours of labor according to the provisions of all the chief collective agreements. Statistics are given annually of the results of profit-sharing and labor copartnership schemes. In the early post-war years the Ministry published surveys of the chief facts regarding labor conditions in other countries. In more recent years it has relied largely on the International Labor Office of the League of Nations to compile this information. Special inquiries are sometimes undertaken into labor conditions abroad, e. g. the study of industrial conditions and industrial relations in Canada and the United States by a delegation which visited these countries in 1926.

The Board of Trade. This department publishes statistics of foreign trade, showing the quantity and value of imports, exports and re-exports. In view of the important part which foreign trade plays in Britain's economic life, these data give valuable indications of the position of industry and are frequently used in industrial negotiations. The Board compiles statistics of wholesale prices and publishes indexes showing changes in the general level of wholesale prices. It also publishes reports giving comprehensive information on the mining industry.

The Board conducts the Census of Production. The intention is to hold a census every five years but so far censuses have been undertaken only in 1907, 1912 (not completed owing to the War) and 1924. The supply of the information is compulsory under the Census of Production Acts. The data provide a valuable review of the industrial development of the

country. In the 1924 census, the statistics for each industrial branch included the selling value of gross output, the cost of materials used, net output, number of persons employed, value of output per person employed, the quantity of mechanical power used and the proportion of total mechanical power which was in reserve or idle during the year. These data were supplemented by an inquiry into earnings and hours conducted by the Ministry of Labor. In this case resort to compulsory powers was not made. A large number of returns were, however, received. The data compiled show for the various branches of industry the average weekly earnings of all work-people covered by the returns, normal hours of labor per week, the hours actually worked, average hourly earnings and the extent of short time. Separate figures are given for male and female workers.

Other Departments. The Ministry of Transport publishes annual statements showing the financial position of the railway companies. Other data are also given including the number of passenger journeys, freight conveyed, total net ton-miles, freight train-miles run and receipts from passenger and freight traffic. This information is supplemented by an annual statement regarding the number of persons employed in the railway service and the average weekly wage rates and average weekly earnings of the chief categories of work-people.

Of an entirely different character are the investigations of the Industrial Fatigue Research Board, which is practically a government institution, set up in 1918 and supported almost entirely by public funds. The object of the Board is to promote better knowledge of the relations of hours of labor and other conditions of employment to the health of the workers and to industrial efficiency. It also endeavors to secure the cooperation of industries in applying the results of its researches. More than thirty investigations have been conducted. It is not necessary to stress the value of this kind of fact-finding on industrial relations.

Various Statutory Requirements. In accordance with Company Law, private and public companies are required to make certain financial statements. Private companies satisfy legal requirements by filing at Somerset House an annual statement

regarding capital. Joint stock and other public companies are required to supply annual statements in the form of balance sheets. The facts which these contain, and especially the dividends declared by various companies, are frequently quoted during industrial negotiations. But the balance sheets frequently fail to reveal the actual financial situation of the various companies. The stated value of assets may differ widely from the real value while hidden reserves, the issue of bonus shares and the "watering" of capital all add to the difficulty of determining what the real profits of a company have been.

More complete information is available regarding the financial position and working of tramways, gas, electricity and other public utility undertakings.

FACT-FINDING BY OTHER BODIES

A number of regular surveys are made for particular industries or for industry as a whole showing economic developments and the present position. These surveys, though not primarily made from the point of view of industrial relations, provide information of value in negotiations. One of the most important of these general compilations is that undertaken by the London and Cambridge Economic Service on the lines of the reviews of economic statistics published by the Harvard Economic Service and other organizations in the United States. The Federation of British Industries publishes each quarter a review of the chief facts of the business situation and makes tentative forecasts regarding probable conditions in the early future. An example of a review of economic conditions in a particular industry is that published quarterly by the British Electrical and Allied Manufacturers' Association in its *Trade Survey*.

In the compilation of information regarding the general facts of the business situation, Great Britain has made less progress than the United States. But it is becoming increasingly recognized that such information can make a valuable contribution, not only to the general economic development of the country, but also to the improvement of industrial relations. Ignorance of the facts by the community is an important cause of exaggerated inequalities of wealth and of wide fluctuations in business activity. These in turn generate

social unrest. It is largely with a view to the diminution of these evils that Mr. John Maynard Keynes, in *The End of Laissez-Faire*, advocates "the collection and dissemination on a great scale of data relating to the business situation, including the full publicity, by law if necessary, of all business facts which it is useful to know".

Reference may be made here to various *ad hoc* inquiries conducted from time to time into economic and labor conditions in particular industries and to general industrial surveys including the problems of industrial relations. Examples of the former type are the Royal Commissions appointed in 1919 and 1925 to inquire into the position of and conditions prevailing in the coal-mining industry. The latter type is represented by the investigations of the Committee on Industry and Trade appointed in 1924 to inquire into the conditions and prospects of British industry and commerce, with special reference to the export trade. Another example is the Liberal Industrial Inquiry which made a complete survey of the problems of British industrial relations.¹

CONCLUSION

The above survey indicates that a considerable amount of valuable information is available for use in British industrial negotiations. It shows equally, however, that important developments are necessary in most industries, if fact-finding is to make its fullest contribution to the promotion of industrial peace.

The main lines of the developments required are indicated in the report of the committee to which reference has been made earlier in this paper.² The committee suggest that the Government, the employers and the trade unions should elaborate a scheme for the compilation and publication of relevant and essential facts. They recognize that such facts would vary from trade to trade, but recommend that information on the following points constitutes a necessary and practicable minimum of data which should be collected and published regularly for each industry:

¹ *Britain's Industrial Future*, especially pp. 143-242. Some of the main features of the *Report* are outlined in Mr. Rowntree's speech, *cf. infra*, p. 162.

² *The Facts of Industry: The Case for Publicity*, pp. 28-9. The Liberal Industrial Inquiry proposes a fact-finding program similar to that formulated in *The Facts of Industry*.

- (a) *Total production*, estimated both in quantities and in money values (selling prices).
- (b) *Cost of material*.
- (c) *Cost of labor*, divided, where the conditions of the industry lend themselves to the distinction, into—
 - (i) *Direct*, i. e., wages which can be booked to individual contracts,
 - (ii) *Indirect*, i. e., wages which cannot be so booked.
- (d) *General charges*, e. g., rents, rates and taxes (other than Income Tax), insurance, depreciation, general office expenses, maintenance and renewal of buildings and plant, and fixed salaries.
- (e) *Balance* available for interest on loan capital, dividends and profits, and for allocation to reserve.
- (f) *Number of wage-earners*, male and female, adult and juvenile, with indications sufficient to show their ages and the rates of wages paid.

These statistics could be compiled satisfactorily only by a permanent body or bodies in regular contact with each industry or group of industries. Neither occasional conferences of employers and workers for collective bargaining nor the existing conciliation and arbitration machinery would be suitable. The work could be undertaken in different industries by Joint Industrial Councils, Trade Boards, or joint committees set up by agreement between employers and workers. For a number of industries the compilations might be made more satisfactorily by a government department in collaboration with the employers and workers.

Agreement by those in control of industry to cooperate in such developments would represent a significant change from the present position, but is likely to be secured only gradually. The change would, however, do much to remove the feeling of suspicion and distrust, based on ignorance of the facts, which is so prolific a cause of industrial conflict. It would give the public a basis for sound judgment regarding the rival claims made by parties to a dispute. It would also provide employers with the information necessary for effective future planning and this would materially reduce the fluctuations of industrial activity which are responsible for much social unrest. Some development on these lines appears necessary if the peaceful and coordinated progress of British industry is to be assured.

PART II
INJUNCTIONS IN LABOR DISPUTES

THE SUPREME COURT'S CONTROL OVER THE ISSUE OF INJUNCTIONS IN LABOR DISPUTES

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THE purpose of this paper is to show the scope of the power of the Supreme Court of the United States to control the issue of injunctions in labor disputes and to point out how this power has thus far been exercised. The Supreme Court is composed of a Chief Justice and eight Associate Justices appointed for life by the President by and with the advice and consent of the Senate. The Constitution does not prescribe their qualifications. In addition to securing to them a life tenure except as they may be removed by impeachment for high crimes and misdemeanors, it safeguards them from reduction of their salaries and has been interpreted by the Supreme Court to save them from a state¹ or federal income tax² on their salaries. The position of Supreme Court Justices is thus a fairly secure one. Political proposals to secure popular revision of their decisions or to limit their power to find constitutional barriers to legislation have not met with approval from the electorate. The independence of the federal judiciary from popular pressure has not diminished with the passing of the years, although in most of our states there have been successful efforts to make the wielders of

¹ The exemption of federal judges from state income taxes is included within the general canon that neither the states nor the United States may tax instrumentalities of the other.

² *Evans v. Gore* (1920), 253 U. S. 245, 40 Sup. Ct. 550, held over the dissent of Justices Holmes and Brandeis that the enforced inclusion of a judicial salary in the gross income reported in assessing a general federal tax on net income is a reduction of the compensation designated by statute prior to the enactment of the federal income tax law. *Miles v. Graham* (1925), 268 U. S. 501, 45 Sup. Ct. 601, holds that an income tax law in force at the time when the judicial compensation is fixed is, if applied to that compensation, a reduction thereof within the prohibition of the Constitution.

judicial power accountable from time to time to the judgment of the electorate.

For the selection of Supreme Court Justices there are no established extra-legal conventions. In many of the states the bar associations exercise an appreciable influence in advising upon nominations and elections or appointments. In some states the courts wield some indirect power to advise. Appointments to federal district courts owe not a little to political recommendations and to that extra-constitutional convention called senatorial courtesy. Doubtless a President will listen to political suggestions in naming a Supreme Court Justice but his choice is pretty much unfettered. This is not the place to tell the story of the appointment of various members of the Supreme Court. It is enough for our present purpose to point out that, viewed in the large, the selection is pretty much a matter of chance.

This introduction would be irrelevant if judges were intellectual automatons in interpreting statutes and constitutions and in deciding issues at common law. It is not irrelevant if judges have a choice how to decide. If such a choice is possible, it makes a difference who does the choosing. It makes a difference whether their choice is practically final. When judges decide issues of common law or of statutory interpretation, legislatures may pass new statutes to substitute new rules for the future. These statutes, however, are subject to the test of constitutionality. If the Justices of the Supreme Court declare unconstitutional a statute of Congress or of a state legislature, it takes a judicial recantation or a constitutional amendment to put into law what the Court has decreed is not law. State constitutional amendments are in many states comparatively easy to secure if there is any strong popular demand for them. In spite of amazement that in one instance at least the federal Constitution has been amended too expeditiously, it still remains true that a Supreme Court decision is not likely to be rendered prospectively impotent by a constitutional amendment. We have reversed the Supreme Court on decisions or declarations that a citizen may sue a state in the federal courts,³ that Congress may not abolish slavery

³ Amendments to the Federal Constitution, Article XI, recalling *Chisholm v. Georgia* (1793), 2 Dall. (U. S.) 1.

in the territories,⁴ and that the United States may not levy an unapportioned income tax on income from property,⁵ but we have left their other decisions unimpaired. Now and then the Supreme Court has overruled itself.⁶ The time may come when the dissents in the cases to be here reviewed will muster a majority of a new Supreme Court and become the law of the land. Until that time arrives, the dissents are mere dissents and of no legal significance, no matter how great their appeal to other thinkers than those who wear the ermine.

Injunctions in labor disputes are not mentioned in the Constitution. Anything that the Supreme Court has to say about them is decided without guidance from the Constitution. From the Constitution comes the power to decide but not the choice of the decision. The wisdom of a decision is therefore open to intellectual debate though no outcome of the debate may alter the course of the law. Nothing in the training or selection of Supreme Court Justices gives them any esoteric wisdom beyond the appraisal of others. There are technical matters on which judges and lawyers may profess peculiar competence, but such technical matters do not dictate the permanent solution of issues of policy. It may take a technician to pierce technical incrustations enough to reach the issues of policy, but the issues of policy are usually there to be reached.

The story of the Supreme Court and labor injunctions begins with the famous *Debs Case*⁷ decided in 1895 by a unanimous court. This sustained an injunction issued by the lower federal court against forcible interference with the interstate transportation of persons and property and the carriage of United States mails. The injunction was issued in response

⁴ Amendments to the Federal Constitution, Article XIII, ending the effect of the declaration in *Dred Scott v. Sandford* (1857), 19 How. (U. S.) 393, that Congress may not prohibit slavery in the territories.

⁵ Amendments to the Federal Constitution, Article XVI, allowing Congress to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, thus overcoming the decision in *Pollock v. Farmers' Loan & Trust Co.* (1895), 157 U. S. 429, 158 U. S. 601, 15 Sup. Ct. 673, 912, that a tax on income from property is a direct tax requiring apportionment.

⁶ See the cases listed by Mr. Justice Brandeis in his dissenting opinion in *Di Santo v. Pennsylvania* (1927), 273 U. S. 34, 43, note 4, 47 Sup. Ct. 267.

⁷ *In re Debs* (1895), 158 U. S. 564, 15 Sup. Ct. 900.

to a bill filed by the United States. The lower court had adduced the Sherman Law in support of the right of the United States to the injunction, but the Supreme Court rested the right on grounds independent of that statute. In the oratorical opinion of Mr. Justice Brewer there is ample language to warrant the inference that the injunction would have been sustained even though carriage of the mails had not been involved.⁸ There is emphasis on the power and the duty of the United States to keep open the channels of interstate commerce and the competency of the United States to invoke the power of the civil courts to remove obstructions to that commerce. Thus without the aid of any state or federal statute specifically authorizing the issue of an injunction, the federal courts at the suit of the United States may enjoin some restraints of interstate commerce.

⁸ The power of the United States to sue for interference with the carriage of the mails is thus expressed :

"Neither can it be doubted that the government has such an interest in the subject-matter as enables it to appear as party plaintiff in this suit. It is said that equity only interferes for the protection of property, and that the government has no property interest. A sufficient reply is that the United States have a property in the mails, the protection of which was one of the purposes of this bill" (158 U. S., at page 583).

This narrower ground of the decision is followed by the broader ground when in the succeeding paragraph it is said :

"We do not care to place our decision on this ground alone. Every government, entrusted by the very terms of its being with powers and duties to be exercised and discharged for the general welfare, has a right to apply to its own courts for any proper assistance in the exercise of the one and the discharge of the other, and it is no sufficient answer to its appeal to one of those courts that it has no pecuniary interest in the matter. The obligations which it is under to promote the interest of all and to prevent the wrong-doing of one resulting in injury to the general welfare is often of itself sufficient to give it a standing in court. . . .

"It is obvious from these decisions that while it is not the province of the government to interfere in the mere matter of private controversy between individuals, or to use its great powers to enforce the rights of one against another, yet, whenever the wrongs complained of are such as affect the public at large, and are in respect of matters which by the Constitution are entrusted to the care of the nation, and concerning which the nation owes the duty to all the citizens of securing to them their common rights, then the mere fact that the government has no pecuniary interest in the controversy is not sufficient to exclude it from the courts, or prevent it from taking measures therein to fully discharge those constitutional duties" (158 U. S., at pages 584, 586).

The next Supreme Court case on injunctions in labor disputes was *Gompers v. Buck's Stove & Range Co.*,⁹ decided in 1911. An injunction against a boycott and blacklist had been issued by the Supreme Court of the District of Columbia at the suit of an injured private party. While interstate commerce was mentioned in the complaint, no relief was asked under the Sherman Law.¹⁰ Apparently the District of Columbia court acted like a state court of general jurisdiction. All that came before the Supreme Court was the propriety of the punishment for contempt for violation of the injunction. The procedure had been one for a civil contempt and the punishment one of a criminal contempt. For this reason and

⁹ (1911) 221 U. S. 418, 31 Sup. Ct. 492, noted in 73 *Cent. L. J.* 3. The decision below is discussed in 25 *Harv. L. Rev.* 375, 385, and 7 *Mich. L. Rev.* 499.

¹⁰ Three years earlier in the famous Danbury Hatters Case—*Loewe v. Lawlor* (1908), 208 U. S. 274, 28 Sup. Ct. 301—the Supreme Court unanimously held a boycott of hats to be a violation of the Sherman Law when participated in by persons not themselves engaged in interstate commerce but for the purpose and with the result of restricting markets outside the state of manufacture and thereby restraining interstate trade. The case arose on demurrer to an action for damages brought by the employer against members of a labor union. This decision is discussed in Jerome C. Knowlton, "Labor Organizations in Legislation", 6 *Mich. L. Rev.* 609; and notes in 42 *Amer. L. Rev.* 315, 518; 8 *Colum. L. Rev.* 413; 21 *Harv. L. Rev.* 450; 56 *U. Pa. L. Rev.* 339; and 17 *Yale L. J.* 616.

For other discussions of legal issues relating to boycotts and injunctions against them, in periodicals published between 1900 and 1910, see James Wallace Bryan, "Injunctions Against Boycotts and Other Illegal Acts", 40 *Amer. L. Rev.* 196; Frederick H. Cooke, "Solidarity of Interests as Basis of Legality of Boycotting", 11 *Yale L. J.* 153; Charles R. Darling, "The Law of Strikes and Boycotts", 52 *Amer. L. Reg. (U. Pa. L. Rev.)* 73; Robert L. McWilliams, "Evolution of the Law Relating to Boycott", 41 *Amer. L. Rev.* 336; Theodor Negaarden, "The Danbury Hatters Case—Its Possible Effect on Labor Unions", 49 *Amer. L. Rev.* 417; Seymour D. Thompson, "Injunctions Against Boycotting", 34 *Amer. L. Rev.* 151; and notes in 4 *Mich. L. Rev.* 143 on the right of a union to declare and carry out a boycott; in 5 *Mich. L. Rev.* 389 on injunction against a boycott in aid of a sympathetic strike; in 15 *Harv. L. Rev.* 223 on the English case of *Quinn v. Leatham*; in 17 *Harv. L. Rev.* 139 on a case refusing an injunction against blacklisting. Boycotting and blacklisting are also considered in a number of the articles cited in note 11, *infra*.

The verdict of the jury in the Danbury Hatters Case was sustained in *Lawlor v. Loewe* (1915), 235 U. S. 522, 35 Sup. Ct. 170, commented on in 24 *Yale L. J.* 605. For proceedings for collection of the judgment, see *Savings Bank of Danbury v. Loewe* (1917), 242 U. S. 357, 37 Sup. Ct. 172, considered in 84 *Cent. L. J.* 173 and 30 *Harv. L. Rev.* 513.

also because the parties had settled their civil controversy, the fine and imprisonment were set aside. The case did not decide whether the injunction would have been sustained on appeal. The opinion remarked, however, that the injunction was not a violation of the constitutional guarantee of freedom of speech. Later proceedings for criminal contempt were set aside on the ground that the statute of limitations had run.¹¹

In 1917 there came before the Supreme Court the question whether the Sherman Law authorized injured private persons to enjoin a boycott in restraint of interstate trade. By a vote of five to four it was held in *Paine Lumber Co. v. Neal*¹² that

¹¹ *Gompers v. United States* (1914), 233 U. S. 604, 34 Sup. Ct. 693. The suggestion that Mr. Gompers might be saved from imprisonment by pardon of the President is discussed in Richard W. Hale, "Injunctions and Pardons", 43 *Amer. L. Rev.* 192.

For articles published between 1900 and 1910, dealing with the law on various phases of labor controversies, see George W. Alger, "The Law and Industrial Inequality", 69 *Albany L. J.* 121; J. B. Ames, "How Far an Act May Be a Tort Because of the Wrongful Motive of the Actor", 18 *Harv. L. Rev.* 411; James Wallace Bryan, "Injunctions Against Strikes", 40 *Amer. L. Rev.* 42; Francis M. Burdick, "Conspiracy as a Crime, and as a Tort", 7 *Colum. L. Rev.* 229; Charles R. Darling, "Recent American Decisions and English Legislation Affecting Labor Unions", 42 *Amer. L. Rev.* 200; A. V. Dicey, "The Combination Laws as Illustrating the Relation Between Law and Opinion in England During the Nineteenth Century", 17 *Harv. L. Rev.* 511; P. L. Edwards, "Labor Strikes and Injunctions", 67 *Albany L. J.* 209; Ernst Freund, "Constitutional Limitations and Labor Legislation", 4 *Ill. L. Rev.* 609; G. G. Groat, "The Court's View of Injunctions in Labor Disputes", 23 *Pol. Sci. Quart.* 408; E. W. Huffcut, "Interference with Contracts and Business in New York", 18 *Harv. L. Rev.* 423; William Draper Lewis, "Some Leading English Cases on Trade and Labor Disputes", 51 *Amer. L. Reg. (U. Pa. L. Rev.)* 125; "The Modern American Cases Arising Out of Trade and Labor Disputes", 53 *Amer. L. Reg. (U. Pa. L. Rev.)* 465; "The Closed Market, the Union Shop, and the Common Law", 18 *Harv. L. Rev.* 444; "Should the Motive of the Defendant Affect the Question of His Liability?—The Answer of One Class of Trade and Labor Cases", 5 *Colum. L. Rev.* 107; W. A. Martin, "Union Labels", 42 *Amer. L. Rev.* 511; Edward F. McClennan, "Some of the Rights of Traders and Laborers", 16 *Harv. L. Rev.* 237; Thomas A. Sherwood, "An Inquiry into the Power of the State to Afford Relief in a Certain Exigency" (coal strike), 37 *Amer. L. Rev.* 545; Glenda Blake Slaymaker, "Labor Legislation; Its Scope and Tendency", 64 *Albany L. J.* 227; Jeremiah Smith, "Crucial Issues in Labor Litigation", 20 *Harv. L. Rev.* 253, 345, 429; D. Y. Thomas, "A Year of Bench Labor Law", 24 *Pol. Sci. Quart.* 80.

¹² (1917) 244 U. S. 459, 37 Sup. Ct. 718, discussed in 85 *Cent. L. J.* 113; 17 *Colum. L. Rev.* 707; 31 *Harv. L. Rev.* 312; 12 *Ill. L. Rev.* 435; 2 *Minn. L.*

it did not. Before this time, however, the Clayton Act of October 15, 1914, had authorized the issue of injunctions at the suit of private persons, subject to restrictions in cases between employers and employees. All the court seemed to assume that the particular case should be governed by the law in force at the time when it arose. Mr. Justice Holmes, who wrote the majority opinion, announced his personal view that the Clayton Act established a policy inconsistent with the grant of an injunction in the case at bar, but announced also that on this point he was in a minority. Here of course was an invitation to attorneys for employers to seek injunctions against boycotts in future cases under the Clayton Act. The minority opinion took the view that it did not require legislation to authorize the grant of an injunction when the court has jurisdiction and finds a wrong for which an injunction seems to it the appropriate remedy. It pointed out that federal jurisdiction had obtained on the two grounds of diversity of citizenship and an action arising under the Sherman Law. This minority view may have future significance because the minority attitude may now have become a majority attitude. If it has, it may be that the Supreme Court would now hold that Congress could not deny the remedy of injunction to the federal courts when the wrong is one which the Supreme Court thinks should be enjoined without the aid of any statute.¹³

Rev. 306; 2 *So. L. Q.* 333. The decision in the court below is treated in 27 *Harv. L. Rev.* 478, 497, but not on the issue whether an injunction may be had by a private party in a suit founded on the Sherman Law. The case was first argued in the Supreme Court on May 3 and 4, 1915. It was restored to the docket for reargument on June 12, 1916, was reargued on October 24 and 25, 1916, and decided on June 11, 1917.

The question whether a right of action for triple damages under the Sherman Law survives the dissolution of the plaintiff corporation is considered in 16 *Colum. L. Rev.* 231, 264.

¹³ The following expressions in the minority opinion of Mr. Justice Pitney indicate the possibility that some judges might hold that it would be an unconstitutional invasion of the prerogatives of the federal judiciary for Congress to dictate restrictions on the exercise of jurisdiction conferred by statute:

"I dissent from the view that complainants cannot maintain a suit for an injunction, and I do so not because of any express provision in the act authorizing such a suit, but because, in the absence of some provision to the contrary, the right to relief by injunction, where irreparable injury is threatened through

In this same year 1917 the Supreme Court decided the famous *Hitchman Case*,¹⁴ which it had had under consideration

a violation of property rights, and there is no adequate remedy at law, rests upon settled principles of equity that were recognized in the constitutional grant of jurisdiction to the courts of the United States" (244 U. S. 459, 473).

"By section 2 of article 3 of the Constitution, the judicial power is made to extend to 'all cases, in law and equity, arising under this Constitution, the laws of the United States', etc. This had the effect of adopting equitable remedies in all cases arising under the Constitution and laws of the United States where such remedies are appropriate. The federal courts, in exercising their jurisdiction, are not limited to the remedies existing in the courts of the respective states, but are to grant relief in equity according to the principles and practice of equity jurisdiction as established in England" (244 U. S. 459, 475-476).

For decisions that in some mysterious fashion the Constitution adopted some requirements of uniformity in the maritime law to be administered in the federal courts in the exercise of the admiralty jurisdiction and that Congress may not defeat this requirement of uniformity by allowing the application of state laws, see *Knickerbocker Ice Co. v. Stewart* (1920), 253 U. S. 149, 40 Sup. Ct. 438. It would be no greater judicial *tour de force* to find that legislative denial of right to relief in equity is an effort to narrow the scope of judicial power defined by the Constitution.

¹⁴ *Hitchman Coal & Coke Co. v. Mitchell* (1917), 245 U. S. 229, 38 Sup. Ct. 65. This case is considered in Walter Wheeler Cook, "Privileges of Labor Unions in the Struggle for Life", 27 *Yale L. J.* 779; Thomas Reed Powell, "Collective Bargaining Before the Supreme Court", 33 *Pol. Sci. Quart.* 396; and notes in 6 *Calif. L. Rev.* 302; 86 *Cent. L. J.* 39; 18 *Colum. L. Rev.* 252; 3 *Cornell L. Q.* 317; 31 *Harv. L. Rev.* 648, 657; 16 *Mich. L. Rev.* 250; 27 *Yale L. J.* 578. The decision in the court below is discussed in 3 *Calif. L. Rev.* 78; 79 *Cent. L. J.* 199; 19 *Yale L. J.* 308. For consideration of somewhat related issues, see notes in 22 *Colum. L. Rev.* 78 on injunction against joining a union in violation of contract; in 26 *Harv. L. Rev.* 349 on common-law liability of a labor union for inducing breach of contract; in 12 *Minn. L. Rev.* 81 on injunction against persuasion to break a "yellow dog" contract; in 73 *U. Pa. L. Rev.* 291 on when inducing breach of contract may be justified; in 10 *Yale L. J.* 252 on malicious interference with employment; and in 27 *Yale L. J.* 961 on enticing away an employee.

Judicial decisions on contracts and activities of labor organizations are considered in notes in 5 *Colum. L. Rev.* 239 on contracts of labor unions in New York; 6 *Colum. L. Rev.* 54 on right of employers to contract to discharge workmen; 7 *Colum. L. Rev.* 408, 427, on remedies and damages in employment contracts; 8 *Colum. L. Rev.* 588 on legality of rules of union; 10 *Colum. L. Rev.* 652, 674, on combination to prevent employment of non-union labor; 25 *Colum. L. Rev.* 647 on legality of combinations to restrict competition in services; 25 *Harv. L. Rev.* 465, 481, on legality of trade unions at common law; 2 *Minn. L. Rev.* 524, 545, on injunction against union rule of minimum of five in an orchestra; 6 *Minn. L. Rev.* 333 on forbidding "we don't patronize" announcement in a labor paper; 62 *U. Pa. L. Rev.* 130 on trade unions and contracts in

since early in 1916. This sustained by a six to three vote an injunction issued by the federal district court against officers of a labor union restraining them from seeking to induce employees to violate a so-called "yellow dog" contract by agreeing to become members of a labor union and keeping the agreement secret until the union organizers were ready to inform the employer. This case started in the federal courts by reason of diversity of citizenship and did not involve the Sherman Law or interstate commerce. While in theory the question whether a wrong was threatened depended upon the law of West Virginia, it was in the absence of any applicable statute of West Virginia a question of so-called general jurisprudence upon which the federal courts reach independent conclusions as to what is the law of the state. There was no applicable statute of West Virginia as to whether the acts were wrongful or whether injunction is the appropriate remedy. Had West Virginia sought to forbid the making of yellow dog contracts, its statute would have been unconstitutional under the *Coppage Case*,¹⁵ decided by a six to three vote of

restraint of trade; 73 *U. Pa. L. Rev.* 211 on contract regulating limitation of output; 13 *Yale L. J.* 194 on competition as justification for interference with employment of fellow workmen; 30 *Yale L. J.* 280, 311, 404, 501, 618, 736, and 31 *Yale L. J.* 86 on present-day labor litigation; and 32 *Yale L. J.* 809 on rights and privileges in labor controversies.

¹⁵ *Coppage v. Kansas* (1915), 236 U. S. 1, 35 Sup. Ct. 240, discussed in 80 *Cent. L. J.* 193; 15 *Colum. L. Rev.* 272; 28 *Harv. L. Rev.* 396, 518; 13 *Mich. L. Rev.* 497; 63 *U. Pa. L. Rev.* 566; 2 *Va. L. Rev.* 540, 551; and 24 *Yale L. J.* 677. The decision below or other decisions on similar statutes are considered in 6 *Boston U. L. Rev.* 201; 75 *Cent. L. J.* 363; 6 *Colum. L. Rev.* 193, 201; 19 *Harv. L. Rev.* 368, 379; 20 *Harv. L. Rev.* 69; 26 *Harv. L. Rev.* 83; 14 *Mich. L. Rev.* 417; 61 *U. Pa. L. Rev.* 193; 3 *Va. L. Rev.* 398; 15 *Yale L. J.* 423; and 25 *Yale L. J.* 413.

The Supreme Court's decision in the *Coppage Case* was in large part predicated upon its earlier decision in *Adair v. United States* (1908), 208 U. S. 161, 28 Sup. Ct. 277, which held unconstitutional the provision in the Erdman Act which made it a crime for an interstate carrier to discharge an employee because of his membership in a labor union. The *Adair Case* is considered in Charles R. Darling, "The *Adair Case*", 42 *Amer. L. Rev.* 884; Richard Olney, "Discrimination Against Union Labor—Legal?", 42 *Amer. L. Rev.* 616; Roscoe Pound, "Liberty of Contract", 18 *Yale L. J.* 454; and notes in 42 *Amer. L. Rev.* 313; 8 *Colum. L. Rev.* 301, 317; 21 *Harv. L. Rev.* 370; and 17 *Yale L. J.* 614. For other notes on the same statute or similar ones see 99 *Cent. L. J.* 219;

the Supreme Court in 1915. This decision illustrates how the power of the Supreme Court to annul state statutes not relating to injunctions may put it within the power of the Supreme Court to determine whether injunctions shall issue.

In such cases as the *Hitchman Case* where no statute is involved and where the federal courts get jurisdiction by reason of diversity of citizenship, the Supreme Court of the United States is in effect the unrestrained legislature to declare what acts of employees and labor organizers are wrongful and when injunction is the appropriate remedy. Lower federal courts must abide by Supreme Court rulings and disregard contrary rulings of state courts. Foreign corporations will usually be able to initiate actions in federal courts rather than in state courts by picking as defendants only those who are not citizens of the state in which the corporation is chartered. States may not forbid foreign corporations to invoke the aid of federal courts¹⁶ or expel them for doing so.¹⁷ They may, however, forbid foreign corporations to engage in manufacture within their borders¹⁸ and by requiring them to become domestic may retain for the state courts jurisdiction of disputes that do not involve interstate commerce or citizens of other states.

While the Supreme Court picks the applicable law in diversity-of-citizenship cases where statutes are not involved, the Supreme Court does not issue the injunction. It merely decides on appeal whether an injunction was wrongly or rightly issued or denied by the federal district judge. The injunction proceedings in the *Hitchman Case* were begun in the federal district court on October 24, 1907. A restraining order was issued on the filing of the bill and continued as a temporary injunction on May 26, 1908. A perpetual injunction was issued on January 18, 1913. Though the decree was reversed by the Circuit Court of Appeals on June 1, 1914, a stay was

16 *Harv. L. Rev.* 221; 20 *Harv. L. Rev.* 499; 1 *Mich. L. Rev.* 142; 10 *Yale L. J.* 256; and 14 *Yale L. J.* 237.

On the validity and collateral effects of contracts to employ only union labor, see 2 *Colum. L. Rev.* 123; 18 *Harv. L. Rev.* 471; 19 *Harv. L. Rev.* 368, 387; 36 *Harv. L. Rev.* 890; 2 *Wis. L. Rev.* 369; 20 *Yale L. J.* 411; and 28 *Yale L. J.* 611.

¹⁶ *Barron v. Burnside* (1887), 121 U. S. 186, 7 Sup. Ct. 931.

¹⁷ *Terral v. Burke Construction Co.* (1922), 257 U. S. 529, 42 Sup. Ct. 188.

¹⁸ *Waters-Pierce Oil Co. v. Texas* (1900), 177 U. S. 28, 20 Sup. Ct. 518.

granted pending resort to the United States Supreme Court. This court granted certiorari on March 13, 1916, heard arguments on March 2 and 3, 1916, and rearguments on December 15 and 16, 1916, and finally on December 10, 1917, over ten years after the injunction had been issued, decided that it had been rightly issued. A decision that it had been wrongly issued would not at that late date have restored the parties to the position that they should have been in a decade earlier.

Thus a single federal district judge may issue an injunction in clear disregard of applicable Supreme Court doctrine and not be reversed by the Circuit Court of Appeals or by the Supreme Court until long after his temporary injunction has effectively disposed of the issue to the wrongful prejudice of the defendants. A district judge who writes a recital of established Supreme Court doctrine has a wide discretion in finding whether there are facts which bring the case within the doctrine justifying an injunction. To a large extent this discretion is in plain fact unreviewable.¹⁹ A conclusion on the facts which is plainly unwarranted may effectively settle the controversy to the wrongful prejudice of the defendants. It is to be remembered that it is contempt to disobey a temporary injunction even though in later appellate proceedings the injunctive decree is set aside.²⁰

That employers are not unaware of the advantages of resort to the federal courts as compared with some state courts is apparent from the effort unsuccessfully made in *Niles-Bement-Pond Co. v. Iron Moulders Union*,²¹ decided by a

¹⁹ In the well-known Rochester Garment Case—*Michaels v. Hillman* (1920), 112 Misc. 395, 183 N. Y. Supp. 195—Judge Rodenbeck's opinion seems to announce principles of law perhaps more favorable to the labor union than those to which it was entitled under the decisions of the New York Court of Appeals and yet to decide the case against it on the facts as found by him. His conclusion may have been warranted, but such warrant is hardly to be found in his recital. The fact that he but weakly supported his conclusion shows that the bite of the law depends largely upon the interpretations which trial judges choose to put upon a confused and complex conglomeration of testimony. No review by an appellate court, even with technical power to review the facts, can be an adequate safeguard against a leaning by a trial court to decide questions of credibility and weight of evidence so as to render reversal difficult.

²⁰ *Howat v. Kansas* (1922), 258 U. S. 181, 42 Sup. Ct. 277, page 70 *infra*.

²¹ (1920) 254 U. S. 77, 41 Sup. Ct. 39, noted in 6 *Va. L. Reg. n.s.* 692. The decision in the court below in its substantive aspects is considered in Howard C. Joyce, "Strikes and their Conduct", 23 *Law Notes* 105.

vote of seven to two in 1920. There was a strike in the plant of an Ohio corporation by Ohio employees. The Ohio corporation was a subsidiary of a New Jersey corporation. The New Jersey corporation sought an injunction in the federal district court for Ohio, making its Ohio subsidiary one of the defendants. As the contracts involved were made with the Ohio corporation, that corporation was a necessary party. The District Judge granted an injunction restraining the strikers from interfering with those who continued to work, but the Circuit Court of Appeals and the Supreme Court held that the Ohio corporation, though an essential party, should because of its control by the New Jersey corporation be aligned with it as party plaintiff rather than as one of the defendants and that therefore the requisite diversity of citizenship was absent.²² Allegations that the case involved interstate commerce and contracts with the United States Government were found to be "much too casual and meager to give serious color to the claim . . . that the cause of action is one arising under the laws of the United States." In this case the injunction was granted at least as early as October 9, 1917, on which day

²² The reason why the Ohio corporation was a necessary party was that it was the employer and that the dispute necessarily involved the contract between it and the striking employees. Unless it were made a party, the decree would not be binding upon it. If the New Jersey corporation should fail to get a decree in a proceeding to which the Ohio employing corporation was not a party, the latter corporation could begin a new action and litigate the issue over again. This was the reason why the court could not entertain jurisdiction to give equitable relief without having before it all the parties essential to a complete ending of the litigation. Equally clear was it that the employing Ohio corporation completely owned by the petitioning New Jersey corporation had no interest adverse to the latter. As Mr. Justice Clarke puts it:

"That there was no, and could not be any, substantial controversy, any 'collision of interest' between the petitioner, the New Jersey corporation, and the Tool Company, the Ohio corporation, is, of course, obvious from the potential control which the ownership of stock by the former gave it over the latter company, and from the actual control effected by the membership of the boards of directors and by the selection of executive officers of the two companies, which have been described.

"Looking, as the court must, beyond the pleadings, and arranging the parties according to their real interest in the dispute involved in the case . . . , it is clear that the identity of interest of the Tool Company with the petitioner required that the two be aligned as plaintiffs, and that with them so classified, the case did not present a controversy wholly between citizens of different states, within the jurisdiction of the district court" (254 U. S. 77, 81-82).

the District Judge filed an opinion with language far from drab. It was not until November 6, 1918, over a year later, that the Circuit Court of Appeals decided that the injunction should not have been issued for the reason that the District Judge should not have taken jurisdiction. The case of federal jurisdiction was so palpably weak that it is hard to escape the suspicion that there must have been substantial rather than procedural reasons for invoking the arm of the federal rather than of the state court.

The next injunction case to reach the Supreme Court was *Duplex Printing Co. v. Deering*,²³ decided in 1921. This reversed by a six to three vote the refusal of a District Judge to issue on behalf of a Michigan manufacturing corporation an injunction against union officials who in New York endeavored to prevent the use of plaintiff's products by threats of strikes against those who bought, used or handled them. Federal jurisdiction had obtained both under the Sherman Act and diversity of citizenship. The question was whether such a boycott had been legalized and rendered immune from injunction by the Clayton Act, as the District Court and Circuit Court of Appeals had held. The majority held that neither the dispute nor the parties came within the restrictive provisions of the Clayton Act. The reference in the Act to suits between the employers and employees²⁴ was said to be con-

²³ (1921) 254 U. S. 443, 41 Sup. Ct. 172, considered in Alpheus T. Mason, "The Labor Clauses of the Clayton Act", 18 *Amer. Pol. Sci. Rev.* 489; and notes in 21 *Colum. L. Rev.* 258; 19 *Mich. L. Rev.* 628; and 1 *Wis. L. Rev.* 187. The effect of the Clayton Act on the power to issue an injunction against a railway strike is considered in 8 *Minn. L. Rev.* 345.

For discussions of the labor provisions of the Clayton Act, published prior to Supreme Court decisions, see Daniel Davenport, "An Analysis of the Labor Sections of the Clayton Anti-Trust Bill", 80 *Cent. L. J.* 46; Edwin E. Witte, "The Doctrine that Labor is a Commodity", 69 *Ann. Amer. Acad. Pol. and Soc. Science* (No. 158) 133; and notes in 30 *Harv. L. Rev.* 632 and 66 *U. Pa. L. Rev.* 267. In the article by Mr. Mason, *cit. sup.*, 18 *Am. Pol. Sci. Rev.* 489, at page 491, note 3, are references to the following discussions in non-technical periodicals prior to the Supreme Court decision: "Labor is not a Commodity", 9 *New Republic* 112 (Dec. 2, 1916); Edwin E. Witte, "Section 20 of the Clayton Act", 9 *New Republic* 243 (1916); Edwin E. Witte, "The Clayton Bill and Organized Labor", 32 *Survey* 360; and Wm. H. Taft, 39 *Rep. Am. Bar Ass'n* 371-380.

²⁴ The first paragraph of Section 20 of the Clayton Act reads as follows:

"That no restraining order or injunction shall be granted by any court of the

fined to suits between employers and employees "substantially concerned as parties to an actual dispute respecting terms or conditions of their own employment, past, present, or prospective." In dissenting Mr. Justice Brandeis pointed out that "Congress did not restrict the provision to employers and workmen *in their employ*" and said that the adoption of a strict technical construction would deny the statute application to disputes between a manufacturer and strikers who by the strike had ceased to be his employees. The majority held further that this was not a dispute "concerning terms or conditions of employment" within the words of the Clayton Act, for the reason that the defendant labor-union officials, not being employees of the plaintiff, were not parties to a dispute concerning terms of employment. Mr. Justice Brandeis replied that this ruling was founded upon a misconception of the facts.

If neither the controversy nor the parties came within the restrictive clauses of the Clayton Act, as the majority thus discovered, there was no need to go further and consider what specific acts were within or without the later paragraph of the statute which began by saying that "no such injunction shall issue to restrain"²⁵ etc., since the word "such" before the

United States, or a judge or the judges thereof, in any case between an employer and employees, or between employers and employees, or between employees, or between persons employed and persons seeking employment, involving, or growing out of, a dispute concerning terms or conditions of employment, unless necessary to prevent irreparable injury to property, or to a property right, of the party making the application, for which injury there is no adequate remedy at law, and such property or property right must be described with particularity in the application, which must be in writing and sworn to by the applicant or by his agent or attorney."

²⁵ This second paragraph of Section 20 of the Clayton Act, which follows immediately the first paragraph quoted in note 24 *supra*, reads as follows:

"And no such restraining order or injunction shall prohibit any person or persons, whether singly or in concert, from terminating any relation of employment, or from ceasing to perform any work or labor, or from recommending, advising, or persuading others by peaceful means so to do; or from attending at any place where such person or persons may lawfully be, for the purpose of peacefully obtaining or communicating information, or from peacefully persuading any person to work or to abstain from working; or from ceasing to patronize or employ any party to such dispute, or from recommending, advising, or persuading others by peaceful and lawful means so to do; or from paying or giving to, or withholding from, any person engaged in such dispute, any strike

word "injunction" confined the ensuing specific clause to injunctions issued in suits and between parties held to be embraced within the preceding clause. Mr. Justice Pitney had already pointed out that "the restriction upon the use of the injunction is in favor only of those concerned as parties to such a suit as is described." Nevertheless he went on to consider what acts are embraced within the specific clauses, under the assumption that "the qualifying effect of the words descriptive of the nature of the dispute and the parties concerned is further borne out by the phrases defining the conduct that is not to be subjected to injunction or treated as a violation of the laws of the United States."²⁶ Thereby he

benefits or other moneys or things of value; or from peaceably assembling in a lawful manner, and for lawful purposes; or from doing any thing or act which might lawfully be done in the absence of such dispute by any party thereto; nor shall any of the acts specified in this paragraph be considered or held to be violations of any law of the United States."

²⁶ Of course it might be proper for the court to render a two-legged decision and say that, even if the parties to the dispute might be thought to be within the first paragraph of Section 20, the conduct here involved was not within the immunity conferred by the second paragraph. This, however, is not what Mr. Justice Pitney does. He has some notion that the conduct described in the second paragraph throws light upon the parties and the disputes embraced in the first paragraph. What he relies on are the recurring words "peaceful or lawful" and "party to such dispute." This, however, in no way shows that by "party to such dispute" Congress meant only employees having or desiring immediate relations with the employer whose product was the subject of the boycott. As Mr. Justice Brandeis points out in his dissent:

"When centralization in the control of business brought its corresponding centralization in the organization of workingmen, new facts had to be appraised. A single employer might, as in this case, threaten the standing of the whole organization and the standards of all its members; and when he did so the union, in order to protect itself, would naturally refuse to work on his materials wherever found. When such a situation was first presented to the courts, judges concluded that the intervention of the purchaser of the materials established an insulation through which the direct relationship of the employer and the workingmen did not penetrate; and the strike against the material was considered a strike against the purchaser by unaffected third parties. . . . But other courts, with better appreciation of the facts of industry, recognized the unity of interest throughout the union, and that, in refusing to work on materials which threatened it, the union was only refusing to aid in destroying itself. . . .

"So, in the case at bar, deciding a question of fact upon the evidence introduced and matters of common knowledge, I should say, as the two lower courts apparently have said, that the defendants and those from whom they sought cooperation have a common interest which the plaintiff threatened. This view is

was enabled to declare in advance what boycotting would be deemed subject to an injunction in a case in which the dispute and the parties were within the Clayton Act, though in the case before the court both dispute and parties were held to be outside the Clayton Act.

The pertinent phrases of the specific clause are that "no such restraining order or injunction shall prohibit any person or persons, whether singly or in concert," from "persuading others by peaceful means" to cease "to perform any work or labor" or from "persuading others by peaceful and lawful means" to cease "to patronize or employ any party to such dispute." Mr. Justice Pitney observes that "the subject of the boycott is dealt with specifically in the 'ceasing to patronize' provision" and declares that "to instigate a sympathetic strike in aid of a secondary boycott cannot be deemed 'peaceful and lawful' persuasion." He fails to note that the words "or lawful" were not in the preceding phrase which forbade an injunction to prohibit persons from persuading others by peaceful means to cease to perform any work. The injunction which the Supreme Court ordered went so far as to cover mere persuasion of employees to decline to work on the boycotted articles. This technically did not introduce into the Clayton Act the words "or lawful" where Congress had omitted them, since the court had already laid down that the case was not within the restrictive clauses of the Clayton Act. Nevertheless the dicta in the opinion on the interpretation of the clauses not involved in the case were an augury that they might be held to mean something different from what they

in harmony with the views of the Court of Appeals of New York. For in New York, although boycotts like that in *Loewe v. Lawlor*, 208 U. S. 274, are illegal because they are conducted not against a product, but against those who deal in it, and are carried out by a combination of persons not united by common interest, but only by sympathy (*Auburn Draying Co. v. Wardell*, 227 N. Y. 1), it is lawful for all members of a union, by whomever employed, to refuse to handle materials whose production weakens the union (*Bossert v. Dhuy*, 221 N. Y. 342; *P. Reardon v. Caton*, 189 App. Div. 501, 178 N. Y. Supp. 713; compare *Paine Lumber Co. v. Neal*, 244 U. S. 459, 471)."

Through all the verbiage of Mr. Justice Pitney's opinion it is apparent that that he is choosing between two opposing common-law rules and then reading his choice into the language of Congress. There is, to my mind, no indication that Congress intended this choice. The most that can be said is that Congress left it possible for the Supreme Court to make such a choice.

said in a case in which it could not be denied that they were applicable.

One does not need to read between the lines of Mr. Justice Pitney's opinion in the Duplex Case to see that his enterprise of literary interpretation was influenced by an independent preference for the result he succeeded in reaching. He observed that changes in the law laid down in interpreting the Sherman Act are not to be inferred. Mr. Justice Brandeis thought that the Clayton Act was designed to substitute some specific tests of legality for the previous views of differing judges as to the requirements of the Sherman Law. Mr. Justice Pitney's leaning against taking Congress as intending anything important is indicated by his statement that "Section 20 [the one restricting the issue of injunctions] must be given full effect according to its terms as an expression of the purpose of Congress; but it must be borne in mind that the section imposes an exceptional and extraordinary restriction upon the equity powers of the courts of the United States, and upon the general operation of the Anti-Trust Laws,—a restriction in the nature of a special privilege or immunity to a particular class, with corresponding detriment to the general public. . . ." ²⁷ Mr. Justice Pitney does not note that it might

²⁷ 254 U. S. 443, 471. A later passage in the opinion discloses even more explicitly that the majority of the court are reading their personal views into the statute:

"The extreme and harmful consequences of the construction adopted in the court below are not to be ignored. The present case furnishes an apt and convincing example. An ordinary controversy in a manufacturing establishment, said to concern the terms or conditions of employment there, has been held a sufficient occasion for imposing a general embargo upon the products of the establishment and a nation-wide blockade of the channels of interstate commerce against them, carried out by inciting sympathetic strikes and a secondary boycott against complainant's customers, to the great and incalculable damage of many innocent people far remote from any connection with or control over the original and actual dispute—people constituting, indeed, the general public upon whom the cost must ultimately fall, and whose vital interest in unobstructed commerce constituted the prime and paramount concern of Congress in enacting the Anti-Trust Laws, of which the section under consideration forms, after all, a part" (254 U. S. 443, 478-479).

The court below, whose construction would have entailed such "extreme and harmful consequences" consisted of Judges Rogers, Hough and Learned Hand. Judge Rogers was in the minority of one. Had Judges Hough and Hand been on the Supreme Court in place of any two of Chief Justice White and Justices

also be borne in mind that prior to the Clayton Act no injunction could rightfully issue under the Sherman Law at the suit of a private party. It does not seem strange that Congress in adding the remedy of injunction to the remedy of triple damages desired to restrict drastically its use in labor disputes. If the earlier case of *Paine Lumber Co. v. Neale*²⁸ is to be taken at its face value, Congress by the Clayton Act, taken as a whole, was not imposing an exceptional and extraordinary restriction upon the equity powers of the United States courts in enforcing the Anti-Trust Laws, but was adding to those equity powers and making clear that its addition was designed to be a limited one. The passage as a whole, with its reference to the "corresponding detriment to the general public" reveals the strong leaning of the majority to reach the result of making the Clayton Act a further curb on labor tactics rather than a curb on the interposition of equity. Mr. Justice Pitney writes as though he were resenting a new restriction on equity powers when what he had to deal with was a limitation on a new addition to equity powers.

While the Duplex Case was being decided there was pending before the court another case in which the application of the Clayton Act to picketing was involved. This was *American Steel Foundries v. Tri-City Central Trades Council*,²⁹ which was first argued on January 17, 1919, over a year before the Duplex Case was argued. The Tri-City Case was re-argued on October 5, 1920, and again on October 5 and 6, 1921, and finally decided on December 5, 1921. This decision of 1921 ordered the District Judge to modify an injunction

McKenna, Day, Van Devanter, Pitney and McReynolds, the decision in the Supreme Court would have gone the other way. Had the case been brought in the New York Court of Appeals, the decision would have been the other way. For a number of years the New York Court of Appeals has been by far the most able and distinguished of our state courts, and few judges of the lower federal courts have enjoyed such high esteem as Judges Hough and Hand. The assurance of Mr. Justice Pitney in the inevitability of his conclusions must for the rest of us be somewhat shaken by this weight of judicial authority against him.

²⁸ Note 12, *supra*.

²⁹ (1921) 257 U. S. 184, 42 Sup. Ct. 72, considered in 10 *Georg. L. J.* 94; 6 *Minn. L. Rev.* 252; 70 *U. Pa. L. Rev.* 102; 8 *Va. L. Rev.* 298; and 31 *Yale L. J.* 408.

issued in 1914, seven years earlier. Whether the defendant, thereupon proceeded to resume the conversation which had been in abeyance during the interim, I have not been able to ascertain.

The Tri-City Case got into the federal courts as a suit by a New Jersey corporation against Illinois employees and labor officials. It was not brought under the Sherman Law. The District Judge had enjoined picketing and persuasion. The Circuit Court of Appeals modified the injunction by eliminating the order against persuasion and by restricting the order against picketing to picketing conducted in a threatening or intimidating manner. The Supreme Court held that the two defendants who were striking employees were entitled to the benefit of the restraints of the Clayton Act. One of these restraints forbade the issue of injunctions against any persons, whether singly or in concert, from recommending, advising, or persuading others by peaceful means to terminate any relation of employment. The benefit conferred in the case at bar was to allow but one representative at each point of ingress and egress of the plant. Apparently there was but a single gate to the enclosure surrounding the plant, so that each employee came out by that same door wherein he went. This would entitle the strikers to one representative. Such representatives, says the Chief Justice, "should have the right of observation, communication and persuasion,"³⁰ but with special

³⁰ The restraint from persuasion which the district judge had included in his injunction was eliminated by the Supreme Court not only in favor of the ex-employees who came within the interpretation of the scope of the Clayton Act, but also in favor of the other defendants who were members of an organization composed of representatives of thirty-seven trade unions of the vicinity. After reciting the pre-existing employment situation in the complainant's plant, the Chief Justice says:

"It is thus probable that members of the local unions were looking forward to employment when complainant should resume full operation, and even though they were not ex-employees within the Clayton Act, they were directly interested in the wages which were to be paid.

"Is interference of a labor organization by persuasion and appeal to induce a strike against low wages, under such circumstances, without lawful excuse and malicious? We think not. Labor unions are recognized by the Clayton Act as legal when instituted for mutual help and lawfully carrying out their legitimate objects. They have long been thus recognized by the courts. They were organized out of the necessities of the situation. A single employee was helpless in dealing with an employer. He was dependent ordinarily on his daily wage for

admonition that . . . they shall not approach individuals together, but singly, and shall not, in their single efforts at communication or persuasion, obstruct an unwilling listener by importunate following or dogging his steps."

"Singly or in concert", says the Clayton Act.³¹ "Not together, but singly", says the Chief Justice in interpreting it. The rule thus laid down was, however, confined to the case at bar in which, seven years earlier, there had been some violence. More latitude may be allowed in quieter strikes. As to picketing, the Circuit Court's qualification of "in a threatening or

the maintenance of himself and family. If the employer refused to pay him the wages that he thought fair, he was nevertheless unable to leave the employ and to resist arbitrary and unfair treatment. Union was essential to give laborers opportunity to deal on equality with their employer. They united to exert influence upon him and to leave him in a body, in order, by this inconvenience, to induce him to make better terms with them. They were withholding their labor of economic value to make him pay what they thought it was worth. The right to combine for such a lawful purpose has, in many years, not been denied by any court. The strike became a lawful instrument in a lawful economic struggle or competition between employer and employees as to the share or division between them of the joint product of labor and capital. To render this combination at all effective, employees must make their combination extend beyond one shop. It is helpful to have as many as may be in the same trade in the same community united, because, in the competition between employers, they are bound to be affected by the standard of wages in their trade in the neighborhood. Therefore, they may use all lawful propaganda to enlarge their membership, and especially among those whose labor at lower wages will injure their whole guild. It is impossible to hold such persuasion and propaganda, without more, to be without excuse and malicious. The principle of the unlawfulness of maliciously enticing laborers still remains, and action may be maintained therefor in proper cases; but to make it applicable to local labor unions in such a case as this seems to us to be unreasonable" (257 U. S. 184, 209-210).

This recognition of a solidarity of interest among the laborers in a restricted industrial area is of course capable of extension by one who might discover that widely-separated plants may compete with each other. The explanation of the apparent inability of some courts thus to enlarge their vision lies very likely in a judgment that the interests of employers and of the purchasing public are to be preferred to the interests of workingmen to promote their aims by the boycotts and the enticements to break "yellow-dog" contracts which have been judicially condemned.

³¹ It may be noted that these words "singly or in concert" thus included in the Clayton Act of October 15, 1914, were not included in the Arizona statute (Section 1464 of the Revised Statutes of Arizona, 1913) dealt with in *Truax v. Corrigan*, note 45 *infra*, though otherwise the Arizona statute reads almost word for word like the Clayton Act.

intimidating manner" was stricken out, and all picketing was enjoined. It is not clear that this strictness is to be confined to turbulent strikes. "Picketing" is a "sinister name", says the opinion. "The name 'picket' indicated a militant purpose, inconsistent with peaceable persuasion." Such logophobia might have asked that the Progressive Convention in 1912 should sing "Abide with Me" rather than "Onward Christian Soldiers." The Chief Justice recognizes that his views and his abhorrence of the word picket are not shared by all courts.³² In states whose courts do not enjoin picketing, employers will naturally seek the federal courts if they are foreign corporations or can claim interference with interstate commerce. What the Chief Justice laid down was of no great importance to the case at bar, for the strike had ended seven years earlier. Its wider significance was to appear two weeks later in *Truax v. Corrigan*,³³ which had been under consideration for a year and a half before the Tri-City Case was decided.

Before taking up *Truax v. Corrigan*, it is well at this point to break into the chronology of the story to tell what labor disputes come within the purview of the Sherman Law. *United States Leather Workers v. Herkert*³⁴ presents the familiar story of an injunction issued by a single federal judge and sustained by the Circuit Court of Appeals only to be later dissolved by the Supreme Court because the trial court was without jurisdiction. The case involved a strike with attendant picketing in 1920 and a Supreme Court decision in 1924 that interstate trade was not involved. The claim to federal

³² On the legality of picketing and the issue of injunctions against it, see 51 *Amer. L. Rev. (U. Pa. L. Rev.)* 703; 52 *Am. L. Rev. (U. Pa. L. Rev.)* 531; 7 *Calif. L. Rev.* 276; 10 *Calif. L. Rev.* 82; 98 *Cent. L. J.* 37; 99 *Cent. L. J.* 383; 6 *Colum. L. Rev.* 124; 18 *Colum. L. Rev.* 372; 21 *Colum. L. Rev.* 103; 27 *Colum. L. Rev.* 190; 12 *Cornell L. Q.* 226; 11 *Georg. L. J. (No. 1)* 52; 15 *Harv. L. Rev.* 482; 18 *Harv. L. Rev.* 471; 40 *Harv. L. Rev.* 896; 10 *Iowa L. Rev.* 79; 5 *Mich. L. Rev.* 712; 15 *Mich. L. Rev.* 671; 20 *Mich. L. Rev.* 242; 21 *Mich. L. Rev.* 786; 1 *Minn. L. Rev.* 437; 64 *U. Pa. L. Rev.* 849; 4 *Wis. L. Rev.* 308; 17 *Yale L. J.* 623; 28 *Yale L. J.* 200, 707; 36 *Yale L. J.* 557; and 37 *Yale L. J.* 249.

In 24 *Harv. L. Rev.* 504 is a note on statutory prohibition of picketing.

³³ (1921) 257 U. S. 312, 42 Sup. Ct. 124, note 45 *infra*.

³⁴ (1924) 265 U. S. 457, 44 Sup. Ct. 623, considered in 19 *Ill. L. Rev.* 351; 3 *Tex. L. Rev.* 105; and 34 *Yale L. J.* 206.

jurisdiction was founded on the fact that ninety per cent of the output of the factory is customarily shipped in interstate commerce. Sanction of such a claim, observed the Chief Justice, would bring every strike within federal jurisdiction, provided an appreciable amount of the manufacturer's product enters into interstate commerce. The added remark that "we cannot think that Congress intended any such result" invites the possible inference that strikes held not to be within the Sherman Law might still be brought within federal jurisdiction by a more specific Congressional enactment. Justices McKenna, Van Devanter and Butler deemed no further legislation necessary and announced their dissent from the reversal of the two courts below.

How little more is needed to make a strike an interference with interstate commerce within the authoritative interpretation of the Sherman Law is apparent from the famous Coronado Case which thus far has been twice before the Supreme Court. This was an action for damages against striking employees and union labor officials. The first verdict for the mining corporation was reversed on the ground that the local unions had confined their efforts to restriction of manufacture and that the International Union had not participated in the restraint.³⁵ On the second trial, in which new evidence was introduced to meet the deficiencies pointed out by the Supreme

³⁵ *United Mine Workers v. Coronado Co.* (1922), 259 U. S. 344, 42 Sup. Ct. 570, considered in Marjorie Jean Bonney, "Federal Intervention in Labor Disputes", 4 *Minn. L. Rev.* 467, 550; James B. McDonough, "Liability of an Unincorporated Union Under the Sherman Law", 10 *Va. L. Rev.* 304; W. Lewis Roberts, "Labor Unions, Corporations—The Coronado Case", 5 *Ill. L. Q.* 200; W. A. Shumaker, "The Coronado Coal Case", 26 *Law Notes* 105; Wesley A. Sturges, "Unincorporated Associations as Parties to Actions", 33 *Yale L. J.* 406; and notes in 10 *Calif. L. Rev.* 506; 22 *Colum. L. Rev.* 684; 11 *Georg. L. J.* 68; 5 *Ill. L. Q.* 126; 1 *Tex. L. Rev.* 114; 9 *Va. L. Rev.* 52; 2 *Wis. L. Rev.* 51; and 32 *Yale L. J.* 37. Much of the discussion in the articles and notes cited is concerned with the ruling in the case that unincorporated labor associations are subject to suit for damages under the Sherman Law. On the issue of the citizenship of a labor union from the standpoint of jurisdiction of the federal courts by reason of diversity of citizenship, see 38 *Harv. L. Rev.* 510; 9 *Minn. L. Rev.* 282; and 34 *Yale L. J.* 564. On the status of unincorporated unions under the Sherman Law see 30 *Harv. L. Rev.* 263, 297 and 2 *St. Louis L. Rev.* 122 for discussions prior to the principal case. The liability of unincorporated associations at common law in England is considered in notes in 15 *Harv. L. Rev.* 311, 317, on the famous *Taff Vale Railway Case*.

Court, there was a directed verdict for the defendants. This, however, was reversed by the Supreme Court,³⁶ which held in effect that the awareness of the local unions that de-unionization in Arkansas would imperil unionization in competing mines in other states was evidence of intention to interfere with interstate commerce which should go to the jury.³⁷ Thus it appears that if local strikers are conscious of striking not for their own sake alone but for the sake of union employees in other states who might be affected by competition between their employers and the employer of the striking Good Samaritans, the jury is at liberty to infer that the strike runs afoul of the Sherman Law. It was in 1925 that this case, begun in 1914, was sent back for its third trial.

How thin is the line between interference with interstate commerce and interference with mere manufacture or building is shown by the contrast between *Industrial Association v. United States*³⁸ and *Bedford Cut Stone Co. v. Journeymen Stone Cutters' Association*.³⁹ The former case involved an

³⁶ *Coronado Coal Co. v. United Mine Workers* (1925), 268 U. S. 295, 45 Sup. Ct. 551, discussed in 74 U. Pa. L. Rev. 321 and 35 Yale L. J. 111.

³⁷ "The mere reduction in the supply of an article to be shipped in interstate commerce by the illegal or tortious prevention of its manufacture or production is ordinarily an indirect and remote obstruction to that commerce. But when the intent of those unlawfully preventing the manufacture or production is shown to be to restrain or control the supply entering and moving in interstate commerce, or the price of it in interstate markets, their action is a direct violation of the Anti-Trust Act. . . . We think there was substantial evidence at the second trial in this case tending to show that the purpose of the destruction of the mines was to stop the production of non-union coal and prevent its shipment to markets of other states than Arkansas, where it would by competition tend to reduce the price of the commodity and affect injuriously the maintenance of wages for union labor in competing mines, and that the direction by the district judge to return a verdict for the defendants other than the International Union was erroneous" (Mr. Chief Justice Taft in 268 U. S. 295, 210).

³⁸ (1925) 268 U. S. 64, 45 Sup. Ct. 403, commented on in 21 Ill. L. Rev. 403. For a review of this decision and the Leather Workers' Case and the second Coronado Case, see 26 Colum. L. Rev. 538-547.

³⁹ (1927) 274 U. S. 37, 47 Sup. Ct. 522, considered in Alexander B. Royce, "Labor, the Federal Anti-Trust Laws, and the Supreme Court", 5 N. Y. Univ. L. Rev. 19; Edwin E. Witte, "The Journeymen Stonecutters' Decision and Other Recent Decisions Against Organized Labor", 17 Am. Labor Legis. Rev. 139; and notes in 40 Harv. L. Rev. 1154; 22 Ill. L. Rev. 444; 26 Mich. L. Rev. 198; 3 Notre Dame Lawy'r 104; 1 St. John's L. Rev. 189, 213; 2 U. Cin. L. Rev. 497; 14 Va. L. Rev. 112, 132; 4 Wis. L. Rev. 250; and 37 Yale L. J. 84.

injunction brought by the United States under the Sherman Law against California building contractors and dealers in building materials who combined to limit sales of materials to employers who pursue an open-shop policy modestly called "The American Plan." The restrictions were for the most part confined to materials of California origin, but their application to materials of extra-state origin was said not to involve the Sherman Law because it did not touch the materials until after their interstate commerce had ended. This is in accord with the general rule which divides state from national power.

The Bedford Stone Case was an injunction against a General Stone Cutters' Union with local branches in many states, restraining it from ordering its members not to work on stone produced by the plaintiff. Of course the stone had ceased its interstate transit and had come to rest before the stone-cutters could work on it, as the plaster and other extra-state materials in the Industrial Association Case had ceased their interstate transit before the dealers refused to sell them to employers who used union labor. The difference seems to be that the dealers in California combined to withhold materials of past extra-state origin merely to keep them from being worked on by union labor, while the stone-cutters combined to keep from working on materials of past extra-state origin in order to keep the materials from coming across state lines to be worked on.⁴⁰

⁴⁰ To these cases should be added *Anderson v. Shipowners Association* (1926), 272 U. S. 359, 47 Sup. Ct. 125, noted in 36 *Yale L. J.* 578, in which an individual sailor on behalf of himself and others similarly situated successfully invoked the Sherman Law and the Clayton Act to enjoin a combination of ship-owners from maintaining an association to which was given complete control over the hiring of seamen to work on the ships of the constituent members of the association. In distinguishing the cases relied on by the defendants, Mr. Justice Sutherland said:

"Here, however, the combination and the acts complained of did not spend their intended and direct force upon a local situation. On the contrary, they related to the employment of seamen for service on ships, both of them instrumentalities of, and intended to be used in, interstate and foreign commerce; and the immediate force of the combination, both in purpose and execution, was directed toward affecting such commerce. The interference with commerce, therefore, was direct and primary, and not, as in the cases cited, indirect and secondary" (272 U. S. 359, 364).

So far as I am aware, this is the only Supreme Court decision in which work-

The boycott in the Stone Cutters Case was perfectly peaceful. The opinion did not make the point that the controversy and the parties were not within the Clayton Act, but went solely on the ground that the Duplex Case had settled that the restraint here imposed was unlawful under the Sherman Law and not made lawful or immune from injunction by the Clayton Act. The majority recognize that the legality of such a peaceful boycott is a question on which state courts differ,⁴¹ but they hold it unlawful under the Sherman Law because they prefer the view that it is unlawful. Justices Sanford and Stone confine their concurrence to recognition that the Duplex Case is authority for the majority view. They were not members of the court when the Duplex Case was decided. Mr. Justice Stone goes further and says that in the light of the policy of the Clayton Act toward organized labor and in the light of the decisions in the Standard Oil and Tobacco Cases⁴² he should not have thought such a boycott

ingmen have successfully invoked the Sherman and Clayton Acts on their own behalf, and this case holds no more than that the bill of the complainant states a case arising under the two Acts.

For law-review discussions of instances of invocation of legal remedies by employees, see 51 *Am. L. Reg. (U. Pa. L. Rev.)* 803 on rights of employees against an employer's blacklist; 1 *Mich. L. Rev.* 142 on forbidding employers to blacklist employees; 33 *Yale L. J.* 215 on enjoining a baker from displaying a sign reading "No Scabs Here"; and 16 *Harv. L. Rev.* 215, 222, on a case denying equitable jurisdiction to enjoin breach of contract to employ only union labor, on the ground that there is adequate remedy at law. In 78 *Cent. L. J.* 272 is a discussion of a statute compelling employers advertising for employees to state when there is a strike, and in 6 *Ill. L. Rev.* 412 a consideration of the discriminatory features of a statute forbidding deceit in hiring workmen.

⁴¹ For discussions of the legality of boycotts and the issue of injunctions against them see, in addition to the articles cited in note 10, *supra*: Howard C. Joyce, "Boycotts", 74 *Cent. L. J.* 263; and notes in 14 *Colum. L. Rev.* 532; 23 *Colum. L. Rev.* 578; 30 *Colum. L. Rev.* 882; 1 *Cornell L. Q.* 133; 3 *Cornell L. Q.* 75; 22 *Harv. L. Rev.* 458; 27 *Harv. L. Rev.* 478, 497; 10 *Iowa L. Rev.* 79; 21 *Mich. L. Rev.* 786; 1 *Minn. L. Rev.* 437; 63 *U. Pa. L. Rev.* 113; and 27 *Yale L. J.* 539, 569. On the proposal to legalize the secondary boycott, see 29 *Harv. L. Rev.* 86.

⁴² *Standard Oil Co. v. United States* (1911), 221 U. S. 1, 31 Sup. Ct. 502, and *United States v. American Tobacco Co.* (1911), 221 U. S. 106, 31 Sup. Ct. 632. These are the cases which reversed prior interpretations of the Sherman Law and held that it prohibits, not all restraints of interstate trade, but only those deemed immoderate or unreasonable. The cases are reviewed and law-review discussions of them are cited in 6 *Minn. L. Rev.* 203-206.

as this an unreasonable restraint. Justices Holmes and Brandeis dissent and think that the Duplex Case involved a different and more serious restraint than this and is therefore not authority for the decision here.⁴³ Three Circuit Judges had held that the defendants were within their rights in conducting such a boycott and had affirmed the District Judge in refusing to issue an injunction. Thus of the thirteen judges who participated in the controversy, only five disclose independent views in favor of the decision, and seven announce independent views against it.

So much for the scope of the Sherman Law⁴⁴ and for the

⁴³ Mr. Justice Brandeis relates in detail the differences between the boycott here involved and that condemned in the Duplex Case. Obviously the differences were sufficient to make the problem quite different from that of the earlier case. Mr. Justice Sutherland goes much too far when he says that "with a few changes, in respect of the product involved, dates, names and incidents, which would have no effect upon the principles established, the opinion in *Duplex Printing Press Co. v. Deering*, *supra*, might serve as an opinion in this case." The principles established in the earlier case are of necessity dependent upon the incidents of the case, unless courts are to decide other cases than those actually before them. When Mr. Justice Sutherland goes on to say that "the object of the boycott there was precisely the same as it is here, and the interferences with interstate commerce, while they were more numerous and more drastic, did not differ in essential character from the interferences here", he means that he chooses to regard as not essential the differences in the methods and the extent of the restraint. This is not applying an established rule, but is making a new rule. Mr. Justice Stone in his concurring opinion points out that the decree of the earlier case went so far as to enjoin the kind of persuasion involved in the second case. This is correct; but, as Mr. Chief Justice Taft pointed out in the Tri-City Case, the restraint imposed by the decree may vary with the situation disclosed by the record. To enjoin even persuasion where there had been intimidation and threats against strangers, does not require that persuasion be enjoined where there has been nothing but persuasion.

⁴⁴ Mention may be made of *United States v. Brims* (1926), 272 U. S. 549, 47 Sup. Ct. 169, which sustained as proper under the Sherman Law a conviction of persons involved in a combination of Chicago manufacturers, contractors and union carpenters under an agreement whereby only union carpenters would be employed by the manufacturers and contractors, and the union carpenters would refuse to install non-union made millwork. The agreement applied to non-union millwork wherever made, and the mills actually most affected were chiefly outside of Illinois. In declaring that a case was made out under the Sherman Law, Mr. Justice McReynolds observed: "It is a matter of no consequence that the purpose was to shut out non-union millwork made within Illinois as well as that made without. The crime of restraining interstate commerce through combination is not condoned by the inclusion of intrastate commerce as well."

Supreme Court's views of picketing and boycotting that are to be deemed unreasonable. These views will be applied by federal courts in cases arising under the Sherman Law notwithstanding contrary views held by state courts or prescribed by state statutes. Views held by state courts will be disregarded by federal courts in cases in which jurisdiction obtains by reason of diversity of citizenship. In such cases, however, the federal courts must follow applicable state statutes. A state statute in the same words as the Clayton Act might be interpreted by a state court to mean something more than the Clayton Act conveyed to the majority of the Supreme Court. The state court's interpretation of the state statute would be accepted by the Supreme Court. The statute as thus interpreted would have to be applied in diversity-of-citizenship cases unless the Supreme Court should hold the state statute unconstitutional. This issue of constitutionality arose in *Truax v. Corrigan*⁴⁵ and was decided against the state statute by a five-to-four vote of the Supreme Court. Arizona had a statute almost identical with the Clayton Act. The Arizona court had thought that the statute meant what it said and that therefore no injunction should issue against

⁴⁵ (1921) 257 U. S. 312, 42 Sup. Ct. 124, considered in Everett P. Wheeler, "Injunctions in Labor Disputes and Decisions of Industrial Tribunals", 8 *A. B. A. Jour.* 506; and notes in 2 *Bost. U. L. Rev.* 124; 10 *Calif. L. Rev.* 237; 22 *Colum. L. Rev.* 252; 7 *Cornell L. Q.* 251; 20 *Mich. L. Rev.* 657; 8 *Va. L. Rev.* 374; 28 *W. Va. L. Q.* 144; 31 *Yale L. J.* 408.

In 16 *Law Notes* 73 is a note on prohibiting actions against trade unions for torts.

A Massachusetts case to the same effect as *Truax v. Corrigan* is considered in 16 *Colum. L. Rev.* 683 and 30 *Harv. L. Rev.* 75, 85.

The injunctive remedy in labor disputes is discussed in 7 *Ill. L. Rev.* 320, 333; 8 *Ill. L. Rev.* 126; 16 *Law Notes* 168; 12 *Mich. L. Rev.* 415; 1 *Minn. L. Rev.* 71; 59 *U. Pa. L. Rev.* 340; 20 *Yale L. J.* 216, 329; and notes in 21 *Mich. L. Rev.* 786 on "conclusions or emotions"; in 23 *Mich. L. Rev.* 52 on nebulous injunctions; and in 73 *U. Pa. L. Rev.* 185 on injunctions to restrain criminal acts. Of course the determining question in many disputes over injunctions is the substantive one of the legal quality of the act complained of. Many of the law-review discussions combine the issue of substance with the issue of equitable jurisdiction. I have classified these references to law reviews as best I can without re-examination of the printed discussions, but the results are bound to be unsatisfactory. The enterprise of gathering the references and of forcing them into some sort of arrangement has been such a wearisome one that I am in no mood to try to improve the grouping notwithstanding my recognition of the great opportunity for improvement.

peaceful picketing. It held that picketing is peaceful if unaccompanied by force or violence. It held the statute constitutional and remarked that it legalizes peaceful picketing. The Supreme Court declared that such an interpretation would render the statute obnoxious to the due-process clause of the Fourteenth Amendment, if applied to picketing that is intimidating and coercive though free from physical force.

The real question in the case was whether it was unconstitutional for the state court to withhold the injunction at the behest of the statute. The Supreme Court did not hold that mere prohibition of injunctive relief is beyond the competence of the state legislature. It did hold, however, that the employer in the case at bar was denied the equal protection of the laws by being deprived of an injunction against intimidating picketers who were his employees when he would not have been denied an injunction against intimidating picketers who were his competitors.⁴⁶ He was deprived of equal protection because his desired remedy was denied him against some instead of against all. The absurdity of such a ground of decision was amply exposed in the dissenting opinion of Mr. Justice Pitney.⁴⁷ Only an overwhelming desire to reach the

⁴⁶ Mr. Chief Justice Taft quotes such generalities as "all men are equal before the law", "this is a government of laws and not of men", and "no man is above the law", and declares: "Thus, the guaranty was intended to secure equality of protection not only for all, but against all similarly situated. Indeed, protection is not protection unless it does so." This may be so, if a majority of the Supreme Court allows one of their number to declare it so. The fallacy in the argument given in its support is apparent from an analogy adduced by the Chief Justice. He supposes a statute making it a crime for all but ex-employees to picket and use abusive language, and then asks: "Is it not clear that any defendant could escape punishment under it on the ground that the statute violated the equality clause of the Fourteenth Amendment?" Of course it is, if the discrimination against those not ex-employees were thought unreasonable. A competitor could claim that he was discriminated against in favor of ex-employees. So in the situation at bar, if an injunction were sought against a competitor, he might claim that he was discriminated against in favor of ex-employees. The employer, however, is not discriminated against because his rights against competitors are more extensive than his rights against employees.

⁴⁷ "Examination shows that it does not discriminate against the class to which plaintiffs belong in favor of any other class. . . .

"It is said that because, under other provisions of the Arizona statute law, plaintiffs would have been entitled to an injunction against such a campaign as

result could have induced such an intellectual strain as the majority opinion indulges in. Apparently the majority were not ready to hold that statutory withdrawal of injunctive relief would deny due process of law. Such a ruling might have realism behind it if it were conceded that it would deny due process to legalize coercive picketing and that the only effective relief against such picketing is relief by injunction. Rights without effective remedies are not very effective rights. Here then was a tenable position, though a novel position and one that has many considerations of judgment against it. It would open the door to numerous judicial difficulties in the future. The position actually taken may avoid some of these difficulties but it must always excite intellectual amazement.

The effect of this majority opinion in *Truax v. Corrigan* is, as Mr. Justice Pitney puts it, "to transform the provision of the Fourteenth Amendment from a guaranty of the 'protection of equal laws' into an insistence upon laws complete, perfect, symmetrical." The door is now open for the Supreme Court to declare that any statute of a state that limits injunctive relief is unconstitutional unless it completely abolishes equity jurisdiction. This will be little more of a strain than the strain already sanctioned by adjudication. Arizona's particular discrimination would be removed if it forbade injunctions against picketing generally instead of only in labor disputes, but it still might be possible to get five Justices to find that a plaintiff is discriminated against if he loses the

that conducted by defendants had it been in a controversy other than a dispute between employer and former employees—for instance, had competing restaurant keepers been the offenders—refusal of relief in the particular case by force of section 1464 is undue favoritism to the class of which defendants are members. But I submit with deference that this is not a matter of which plaintiffs are entitled to complain under the 'equal protection' clause. There is no discrimination *against them*; others situated like them are accorded no greater right to an injunction than is accorded to them. . . . Cases arising under this clause of the Fourteenth Amendment pre-eminently call for the application of the settled rule that before one may be heard to oppose state legislation upon the ground of its repugnance to the Federal Constitution, he must bring himself within the class affected by the alleged unconstitutional feature. . . .

"A disregard of the rule in the present case has resulted, as it seems to me, in treating as a discrimination what, so far as plaintiffs are concerned, is no more than a failure to include in the statute a case which, in consistency, ought, it is said, to have been covered—an omission immaterial to plaintiffs" (257 U. S. 312, 349-351).

opportunity to get an injunction against a specified act instead of against all acts. It therefore seems hardly worth while to speculate as to ways in which states might possibly restrict their own courts in issuing injunctions in labor disputes. Those ways must pass muster with a far-away court which has written an opinion which can be used as a precedent for any result that it wishes to reach.

A few other results which the Supreme Court has thus far reached with respect to injunctions in labor disputes remain to be catalogued. The Kansas Industrial Court plan of compulsory arbitration was declared unconstitutional in *Wolff Packing Co. v. Court of Industrial Relations*,⁴⁸ decided in 1923. The actual decision was that an employer may not be compelled by mandamus to put into effect an order of an administrative body with regard to wages in a packing house when the order is the fruit of a statute under which it would be a crime for the employer to cease operations to defeat the

⁴⁸ (1923) 262 U. S. 522, 43 Sup. Ct. 630, discussed in Minor Bronaugh, "Business Clothed with a Public Interest Justifying State Regulation", 27 *Law Notes* 87; William L. Huggins, "Just What Has the Supreme Court Done to the Kansas Industrial Act? Why Did It Do It?", 11 *A. B. A. Jour.* 363; C. Petrus Peterson, "Industrial Courts", 3 *Neb. L. B.* 487; Herbert Rabinowitz, "The Kansas Industrial Court Act", 12 *Calif. L. Rev.* 1; Sidney Post Simpson, "Constitutional Limitations on Compulsory Industrial Arbitration", 38 *Harv. L. Rev.* 753; and notes in 12 *Calif. L. Rev.* 35; 96 *Cent. L. J.* 273; 38 *Harv. L. Rev.* 1097; 22 *Mich. L. Rev.* 135; and 33 *Yale L. J.* 196.

For discussions prior to the Supreme Court decision, see John T. Clarkson, "The Industrial Court Bill", 6 *Iowa L. Bull.* 153; J. S. Dean, "The Fundamental Unsoundness of the Kansas Industrial Court Law", 7 *A. B. A. Jour.* 333; John A. Fitch, "Government Coercion in Labor Disputes", 80 *Ann. Amer. Acad. Pol. and Soc. Science* (No. 179) 74; William L. Huggins, "A Few of the Fundamentals of the Kansas Industrial Court Act", 7 *A. B. A. Jour.* 265; H. W. Humble, "The Court of Industrial Relations in Kansas", 19 *Mich. L. Rev.* 675; Fred H. Peterson, "Industrial Court", 85 *Cent. L. J.* 352; F. Dumont Smith, "The Kansas Industrial Court", 47 *Rep. Am. Bar Ass'n* 208, and 95 *Cent. L. J.* 456; "Practical Operation of Kansas Industrial Court Law", 8 *A. B. A. Jour.* 680; William R. Vance, "A Proposed Court of Conciliation", 1 *Minn. L. Rev.* 107; "The Kansas Court of Industrial Relations with its Background", 30 *Yale L. J.* 456; George W. Wickersham, "Recent Extensions of State Police Power", 54 *Amer. L. Rev.* 801; J. S. Young, "Industrial Courts with Special Reference to the Kansas Experiment", 5 *Minn. L. Rev.* 39, 185, 353; and notes in 20 *Mich. L. Rev.* 893; 6 *Minn. L. Rev.* 69, 159, 251; and 31 *Yale L. J.* 75, 206, 889. Still earlier discussions of the problem of arbitration of industrial disputes are cited in note 54, *infra*.

compulsory arbitration feature of the Act.⁴⁹ The opinion made it clear that it would be deemed equally unconstitutional to forbid the employees to conspire to strike in resistance to an order of the arbitration tribunal, but this observation was carefully restricted to enterprises in which no compelling public necessity requires continuity of operations.⁵⁰ Indeed Mr. Chief Justice Taft went so far as to imply that the decision sustaining the Adamson Law⁵¹ had definitely established that

⁴⁹ A similar ruling was made in *Wolff Packing Co. v. Court of Industrial Relations* (1925), 267 U. S. 552, 45 Sup. Ct. 441, with regard to the statutory authority granted to an administrative board to fix the hours of labor in the industries covered by the Kansas Industrial Relations Act. The court did not pass upon the independent power to fix hours of labor but held that the power conferred was unconstitutional because inseparably connected with the system of compulsory arbitration. This decision is considered in Minor Bronaugh, "Compulsory Arbitration of Wages and Hours of Labor—End of Kansas Industrial Relations", 29 *Law Notes* 28; William L. Huggins, "Just What Has the Supreme Court Done to the Kansas Industrial Act? Why Did It Do It?", 11 *A. B. A. Jour.* 363; Dexter Merrian Keezer, "Some Questions Involved in the Application of the 'Public Interest' Doctrine", 25 *Mich. L. Rev.* 596; and a note in 24 *Mich. L. Rev.* 59.

In 17 *Colum. L. Rev.* 174 is a review of mediation and arbitration statutes, and in 22 *Mich. L. Rev.* 49 a note on conciliation of labor controversies under the North Dakota Act of 1921.

⁵⁰ "These words refute the view that public regulation in such cases can secure continuity of a business against the owner. . . . If that be so with the owner and employer, *a fortiori* must it be so with the employee. It involves a more drastic exercise of control to impose limitations of continuity growing out of the public character of the business upon the employee than upon the employer; and without saying that such limitations upon both may not be sometimes justified, it must be where the obligation to the public of continuous service is direct, clear, and mandatory, and arises as a contractual condition, express or implied, of entering the business either as owner or worker. It can only arise when investment by the owner and entering the employment by the worker create a conventional relation to the public somewhat equivalent to the appointment of officers and the enlistment of soldiers and sailors in military service" (262 U. S. 522, 541).

The so-called implied contract by which the worker might agree to continuity of labor is of course merely a possible judicial fiat that certain employments may be so essential to the public welfare that the legislature or the court may impose upon those engaged therein the duty not to quit in such a manner as seriously to interrupt the service.

⁵¹ *Wilson v. New* (1917), 243 U. S. 332, 37 Sup. Ct. 298, discussed in Arthur A. Ballantine, "Railway Strikes and the Constitution", 17 *Colum. L. Rev.* 502; Charles W. Bunn, "The Supreme Court and the Adamson Law", 1 *Minn. L. Rev.* 395; Frank Warren Hackett, "The Adamson Act Decision", 52 *Amer. L.*

the right of employees of extensive railway systems "to demand wages and leave the employment individually or in concert was subject to limitation by Congress because in a public business which Congress might regulate under the commerce power." There were remarks to that effect in the opinion of Mr. Chief Justice White in the Adamson Law Case,⁵² but

Rev. 23; Albert M. Kales, "Due Process; The Inarticulate Major Premise and the Adamson Act", 26 *Yale L. J.* 519; Thomas Reed Powell, "The Supreme Court and the Adamson Law", 65 *U. Pa. L. Rev.* 607; and notes in 84 *Cent. L. J.* 256, 317; 17 *Colum. L. Rev.* 422, 445; 30 *Harv. L. Rev.* 739; 10 *Me. L. Rev.* 180; and 26 *Yale L. J.* 496. For discussions prior to the Supreme Court decision see Malcolm H. Lauchheimer, "The Constitutionality of the Eight Hour Railroad Law", 16 *Colum. L. Rev.* 554; Thomas Reed Powell, "Due Process and the Adamson Law", 17 *Colum. L. Rev.* 114; Harry T. Smith, "The Eight Hour Railway Wage Law", 4 *Va. L. Rev.* 83; and notes in 30 *Harv. L. Rev.* 63; 20 *Law Notes* 164; and 10 *Me. L. Rev.* 54. The situation which led to the passage of the Adamson Law is related in E. C. Robbins, "The Trainmen's Eight-Hour Day", 31 *Pol. Sci. Quart.* 541; 32 *Pol. Sci. Quart.* 412.

⁵² "Here again it is obvious that what we have previously said is applicable and decisive, since whatever would be the right of an employee engaged in a private business to demand such wages as he desires, to leave the employment if he desires, to them, and, by concert of action, to agree with others to leave upon the same condition, such rights are necessarily subject to limitation when employment is accepted in a business charged with a public interest and as to which the power to regulate commerce possessed by Congress applied, and the resulting right to fix, in case of disagreement and dispute, a standard of wages, as we have seen, necessarily obtained" (243 U. S. 332, 352-353).

On the problem of the power to forbid strikes in employments other than those clearly private, see Arthur A. Ballantine, "Railway Strikes and the Constitution", 17 *Colum. L. Rev.* 502; Marjorie K. Baumgartner, "The Thirteenth Amendment and Strikes on Public Utilities", 6 *Bi-Mon. L. Rev.* 109; S. H. Kauffman, "Limiting the Right to Strike", 84 *Cent. L. J.* 121; Walter B. Kennedy, "Law and the Railroad Labor Problem", 32 *Yale L. J.* 553; Blewett Lee, "The Thirteenth Amendment and the General Railway Strike", 4 *Va. L. Rev.* 437; Philip Wager Lowry, "Strikes and the Law", 21 *Colum. L. Rev.* 783; O. R. McGuire, "The Injunction and the Railroad Strike", 11 *Georg. L. J.* 1; P. A. Pare, "The Right to Enforced Labor Notwithstanding the Thirteenth Amendment", 7 *Bi-Mon. L. Rev.* 4; Thomas I. Parkinson, "Constitutional Aspects of Compulsory Arbitration", 7 *Proc. Acad. Pol. Sci.* (N. Y.) 44, in no. 1 of vol. VII, entitled "Labor Disputes and Public Service Corporations"; George Jarvis Thompson, "Labor and the Law in the Public Utility Field", 21 *Mich. L. Rev.* 1; and notes in 35 *Harv. L. Rev.* 459, 474, and 20 *Mich. L. Rev.* 548 on Judge Anderson's injunction against the coal strike; in 7 *Cornell L. Q.* 61 on injunction against a strike at the suit of the state; in 10 *Georg. L. J.* (no. 2) 119 on prohibition of strikes by statute; in 34 *W. Va. L. Q.* 176 on injunction against a coal strike; and in 17 *Ill. L. Rev.*

they were gratuitous. The only Supreme Court decision on the right of railway employees to strike is *Ex parte Lennon*,⁵³ decided in 1897, which held no more than that an engineer may be punished for contempt in violating an injunction not to boycott certain cars, when his announcement that he was quitting the service was regarded as a mere trick or device to evade the injunction. Thus the issue whether a court may compel the performance of a contract of personal service did not fairly arise.⁵⁴

440; 21 *Mich. L. Rev.* 90; and 71 *U. Pa. L. Rev.* 83 on injunction against a railway strike. For a discussion of "Strike Injunctions Obtained by the United States" see Zechariah Chafee, Jr., *The Inquiring Mind* (New York; Harcourt, Brace and Company, 1928), pp. 198-216. This is preceded by a section on "Strike Injunctions Obtained by Coal Operators" (pp. 190-197). For discussions prior to 1910 see 37 *Amer. L. Rev.* 285, 461, on injunction against persuading railway employees to strike, and 16 *Harv. L. Rev.* 518, 524, on the Wabash injunction against a peaceful strike.

⁵³ (1897) 166 U. S. 548, 17 Sup. Ct. 658.

⁵⁴ By the Transportation Act of 1920 Congress created a Railroad Labor Board with power to hear controversies between carriers and representatives of employees, to pass judgment thereon and to communicate its decisions to the parties and to designated governmental authorities, and to give its action such further publicity as it might determine. The provisions of the statute are reviewed in 25 *Colum. L. Rev.* 882. Complaints of a carrier against action of the Board in allowing employees to vote for labor organizations as their representatives at conferences before the Board and of the threatened action of the Board in giving publicity to the fact that the carrier had disregarded the decision of the Board were held in *Pennsylvania Railroad Co. v. Railroad Labor Board* (1923), 261 U. S. 72, 43 Sup. Ct. 278, to have no constitutional basis, since the Board was not vested with any coercive power. The decision is discussed in 2 *Wis. L. Rev.* 500. In *Pennsylvania Railroad System v. Pennsylvania Railroad Co.* (1925), 267 U. S. 203, 45 Sup. Ct. 307, and *Pennsylvania System Board v. Pennsylvania Railroad Co.* (1925), 267 U. S. 219, 45 Sup. Ct. 312, the court refused to enjoin the defendant carrier from withholding compliance with the orders of the Labor Board and going ahead with its own plan of selecting representatives of employees to confer with it and enter into agreements respecting wages and conditions of employment. The cases are noted in 38 *Harv. L. Rev.* 986, and an anticipatory discussion appears in 38 *Harv. L. Rev.* 374, 402. An issue as to the claims of employees with respect to reductions not sanctioned by the Labor Board is discussed in 22 *Colum. L. Rev.* 682.

For earlier discussions of the problem of arbitration of industrial disputes and of foreign experience with arbitration tribunals see Henry Winthrop Ballantine, "Evolution of Legal Remedies as a Substitute for Violence and Strikes", 69 *Ann. Amer. Acad. Pol. and Social Science* (no. 158) 140; James H. Brewster, "A Comparison of Some Methods of Conciliation and Arbitration

Prior to this square decision on the Kansas statute, a punishment for contempt for disobeying an order not to call a strike was sustained by the Supreme Court in *Howat v. Kansas*⁵⁵ upon the finding that the Kansas court had issued the injunction independently of any enforcement of the Industrial Relations Court Act and that therefore no federal question was presented. The state court had held that the question of the validity of the injunction could not be raised collaterally as a defense to a proceeding for contempt for violating it. The Supreme Court recites that this is established law.⁵⁶ The thing to do is to obey and await the long process of appellate adjudication to find out if the injunction was wrongfully issued.

The Kansas statutory prohibition against calling a strike

of Industrial Disputes", 13 *Mich. L. Rev.* 185; L. Ward Bannister, "The Administrative Settlement of Industrial Disputes by Compulsory Arbitration", 2 *Cornell L. Q.* 163; W. Jethro Brown, "The Judicial Regulation of Industrial Conditions", 27 *Yale L. J.* 425; "Effect of an Increase in the Living Wage by a Court of Industrial Arbitration Upon Vested Rights and Duties Under Pre-existing Awards", 32 *Harv. L. Rev.* 892; "The Separation of Powers in British Jurisdictions", 31 *Yale L. J.* 24; Henry B. Higgins, "A New Province for Law and Order", 29 *Harv. L. Rev.* 13; 32 *Harv. L. Rev.* 189; 34 *Harv. L. Rev.* 105; S. H. Kauffman, "Limiting the Right to Strike", 84 *Cent. L. J.* 121; George S. Ramsay, "The Power and Duty of the State to Settle Disputes Between Employer and Employee", 51 *Amer. L. Rev.* 801; Howard S. Ross, "The Canadian Industrial Dispute Investigation Act", 2 *Cornell L. Q.* 176; Carl I. Wheat, "American Legislation for the Adjustment of Industrial Disputes", 28 *W. Va. L. Q.* 29.

⁵⁵ (1922), 258 U. S. 181, 42 Sup. Ct. 277, noted in 31 *Yale L. J.* 889.

⁵⁶ "An injunction duly issuing out of a court of general jurisdiction with equity powers, upon pleadings properly invoking its action, and served upon persons made parties therein and within the jurisdiction, must be obeyed by them, however erroneous the action of the court may be, even if the error be in the assumption of the validity of a seeming but void law, going to the merits of the case. It is for the court of first instance to determine the question of the validity of the law, and until its decision is reversed for error by orderly review, either by itself or by a higher court, its orders based on its decision are to be respected, and disobedience of them is contempt of its lawful authority, to be punished" (258 U. S. 181, 189-190).

The state court had invoked the Debs Case for the proposition that quite aside from the Industrial Court Act the lower court had power to issue the injunction "on principles identical with those applied in abatement of public nuisances." If state courts choose to forbid strikes without invoking any statute in support of their decree, there is no federal question as a basis for review by the United States Supreme Court.

came before the Supreme Court in two other cases, both called *Dorchy v. Kansas*. The first decision⁵⁷ sent the case back to the state court to determine whether the anti-strike provision was separable from the rest of the Court of Industrial Relations Act which had been declared unconstitutional. The Kansas court held that it was and affirmed the conviction for disobeying the statute. The Supreme Court sustained the conviction⁵⁸ on the narrow ground that the statute was here applied only against an order to strike to compel an employer to pay a disputed stale claim of an employee. Strikes for such a purpose may be forbidden and those who call them may be punished criminally.⁵⁹ Presumably a statutory command to enjoin the calling of a strike for this purpose would also be sustained.

The advantage to employers of the injunctive process as compared with civil actions or prosecutions for crime is not confined to the superiority of prevention over recompense or punishment. It is easier to get an order from one man than

⁵⁷ *Dorchy v. Kansas* (1924), 264 U. S. 286, 44 Sup. Ct. 323, noted in 13 *Calif. L. Rev.* 81.

⁵⁸ *Dorchy v. Kansas* (1926), 272 U. S. 306, 47 Sup. Ct. 86, commented on in 40 *Harv. L. Rev.* 626; 21 *Ill. L. Rev.* 727; 5 *No. Car. L. Rev.* 244; and 75 *U. Pa. L. Rev.* 268. In the Lawyers' Edition of the Supreme Court Reports, volume 71, pages 248-268, is an extended note on "Purposes for which Strike may Lawfully be Called."

⁵⁹ "The right to carry on business—be it called liberty or property—has value. To interfere with this right without just cause is unlawful. The fact that the injury was inflicted by a strike is sometimes a justification. But a strike may be illegal because of its purpose, however orderly the manner in which it is conducted. To collect a stale claim due to a fellow member of the union who was formerly employed in the business is not a permissible purpose. In the absence of a valid agreement to the contrary, each party to a disputed claim may insist that it be determined only by a court. . . . To enforce payment by a strike is clearly coercion. The legislature may make such action punishable criminally, as extortion or otherwise. . . . And it may subject to punishment him who uses the power or influence incident to his office in a union to order the strike. Neither the common law, nor the Fourteenth Amendment, confers the absolute right to strike" (272 U. S. 306, 311, per Mr. Justice Brandeis).

The legality of strikes, liabilities for strikes, and the issue of injunctions against strikes are considered in 13 *Colum. L. Rev.* 66, 79; 17 *Harv. L. Rev.* 135, 140, 285; 19 *Harv. L. Rev.* 68; 20 *Harv. L. Rev.* 243; 21 *Harv. L. Rev.* 635; 22 *Harv. L. Rev.* 234; 26 *Harv. L. Rev.* 259, 277; 39 *Harv. L. Rev.* 101, 128; 10 *Mich. L. Rev.* 637; 15 *Mich. L. Rev.* 673; 16 *Mich. L. Rev.* 57, 137; and 18 *Yale L. J.* 425. In 31 *Yale L. J.* 320 is a consideration of what is a strike.

a verdict from twelve. Proceedings for contempt for alleged violation of an injunction are traditionally heard by a single chancellor who finds the facts, adjudges guilt or innocence and prescribes what shall be done in case of guilt. This, as all good lawyers know, is not criminal prosecution or punishment, though the result may be the imposition of a fine or imprisonment. Untutored laymen who have been fined or incarcerated upon the order of a single judge for disobedience of an injunction have appreciated that the procedure is not that of criminal prosecution but have felt that the results are not strikingly different. In response to such a feeling, Congress provided by the Clayton Act that disobedience to an injunction by acts which are also a crime should upon demand of the offender be proceeded against in an action in which the "trial shall conform, as near as may be, to the practice in criminal cases." A federal district judge declined to follow the command of the statute on the ground that it was unconstitutional. The Circuit Court of Appeals agreed with him on the theory that the power of the federal courts to deal with contempts without interposition of a jury is inherent in the judicial power derived from the Constitution. The Supreme Court in *Michaelson v. United States*⁶⁰ interpreted the statute as confined to criminal contempts and sustained it when further confined to acts committed out of the presence of the court, acts which are positive crimes and not mere failures to comply affirmatively with some decree. These restrictive interpretations of the statute were confessedly the product of a desire to avoid the so-called grave constitutional issues which would be presented if the statute were accorded the wider scope which its language might allow.⁶¹

⁶⁰ (1924) 266 U. S. 42, 45 Sup. Ct. 18, considered in 25 *Colum. L. Rev.* 229; 10 *Cornell L. Q.* 215; 38 *Harv. L. Rev.* 259; 19 *Ill. L. Rev.* 449; 13 *Ky. L. J.* 236; 9 *Minn. L. Rev.* 368, 378; 4 *Oregon L. Rev.* 145; 3 *Tex. L. Rev.* 206. For discussions prior to the Supreme Court decision, see Felix Frankfurter and James M. Landis, "Power of Congress over Procedure in Criminal Contempts in 'Inferior' Federal Courts—A Study in Separation of Powers", 37 *Harv. L. Rev.* 1010, reprinted in 58 *Amer. L. Rev.* 696, 818; and notes in 37 *Harv. L. Rev.* 486, 499; and 33 *Yale L. J.* 791.

⁶¹ These restrictions of the statute amount practically to emasculation. It will not be applied to civil contempts, and judges on motion of the complainant may entertain civil proceedings instead of criminal proceedings. It does not apply when the acts enjoined are not crimes, and the Supreme Court has made rules

Thus the power of the federal courts over civil contempts is by adjudication left untouched by Congress and by inference it must continue to be left untouched. The inference does not necessarily extend to state efforts to restrict state courts in the matter of civil contempts, since state restriction of state judicial power does not of itself present a federal constitutional question. If, however, such a restriction is deemed to deprive suitors of rights and remedies which the Supreme Court thinks a decent government should give them, the deprivation may be adjudged to be a denial of the due process or of the equal protection of the laws required by the Fourteenth Amendment. With *Truax v. Corrigan*⁶² as a precedent, the Supreme Court that sustained the emasculated Clayton Law provision because of its narrow scope might call a similarly narrow state regulation a denial of equal protection of the laws because it was not broader.

This concludes the survey of the ground already covered by Supreme Court decisions. We have speculated somewhat, though vainly, as to what the court would do about possible state statutes designed to secure for strikers and boycotters some further shields against the strong arm of the state judiciary. The *Truax* Case makes one wonder also what the Supreme Court would do if Congress should forbid the federal courts to issue injunctions in cases in which the Supreme Court thinks injunctions ought to issue. There would not be the equal-protection clause to invoke, but it has been hinted that severe inequalities would offend due process of law, and Congress is restricted by a due-process clause. There is the principle of the separation of powers to invoke if the court thinks that the legislature has sought to deprive it of something which is of the essence of judicial power. The jurisdiction of the lower federal courts may be restricted by Congress, but the Supreme Court has declared that Congress is restricted in prescribing how jurisdiction conferred shall be exercised.⁶³

of law authorizing the enjoining of boycotting and picketing which are not only not crimes but are not even a basis for an action for damages under the common law as revealed to the courts of some states.

⁶² Note 45, *supra*.

⁶³ In the *Michaelson* Case, note 60, *supra*, 266 U. S. 42, at pages 65-66, Mr. Justice Sutherland says:

"But it is contended that the statute materially interferes with the inherent

We do not know that the court would let Congress overrule *Swift v. Tyson*⁶⁴ and make federal courts follow decisions of state courts on common-law issues. The Sherman Law could be repealed; but could it be amended so as not to apply to designated acts of labor organizations? It would be a terrible strain to hold that it could not, and it would be hard to hurdle the Paine Lumber Case⁶⁵ to hold that Congress could not withhold the remedy of injunction from all private persons or from all designated controversies. Even if there were no Sherman Law, however, there is still the Debs Case to authorize injunctions by the government against any widespread interference with interstate commerce.

Doubtless the questions we have been raising are academic, because neither Congress nor the states will be likely to pass the legislation which would raise them. Congress has thus far acquiesced in the decision that the Clayton Act with all its specifics restrained the federal courts from nothing that was previously proper. A statute full of words that seemed a balm to labor turned out upon interpretation to be chiefly a bane, and Congress has since kept still. The future law of labor injunctions bids fair to be judge-made law like so much of the law of the past,—judge-made by five-to-four decisions, often years after the practical issue had been practically settled perhaps by an erroneous decision of a trial judge. If this

power of the courts, and is therefore invalid. That the power to punish for contempts is inherent in all courts has been many times decided and may be regarded as settled law. It is essential to the administration of justice. The courts of the United States, when called into existence and vested with jurisdiction over any subject, at once become possessed of this power. So far as the inferior courts are concerned, however, it is not beyond the authority of Congress . . . ; but the attributes which inhere in that power and are inseparable from it can neither be abrogated nor rendered practically inoperative."

⁶⁴ (1842) 16 Pet. (U. S.) 1. This was the decision in which Mr. Justice Story invented the doctrine of "general jurisprudence" and held that the federal courts were obeying the dictate of Congress to regard the laws of the several states as rules of decision, when these federal courts chose their own preferred common-law rule instead of following the common-law rule pleasing to the state court. For a belated criticism of this decision by one who has in his time applied it not infrequently, see Mr. Justice Holmes, dissenting, in *Black & White Taxicab Co. v. Brown & Yellow Taxicab Co.* (1928), 48 Sup. Ct. 404.

⁶⁵ Note 12, *supra*.

judge-made law is compounded more of folly than of wisdom, the major remedy seems to lie in educating the judges of the future. State judges may still be the arbiters in controversies governed by no statute and not between citizens of different states.⁶⁶ Of all other controversies the Supreme Court of the United States is the ultimate arbiter.

On issues of common law, of statutory construction, and of

⁶⁶ For general articles on law in its relation to industrial disputes, published between 1910 and 1928, see A. A. Bablitz, "Labor Unions and Their Relation to the Law in the United States", 2 *Ky. L. J.* (no. 7) 9; Jay Newton Baker, "The American Federation of Labor", 22 *Yale L. J.* 73; Newton D. Baker, "Labor Relations and the Law", 8 *A. B. A. Jour.* 731; Ernest C. Carman, "The Outlook from the Present Legal Status of Employers and Employees in Industrial Disputes", 6 *Minn. L. Rev.* 553; Walter Carrington, "Injunctions in Labor Controversies", 8 *Va. L. Reg. n.s.* 401; J. P. Chamberlain, "The Legislature and Labor Injunctions", 11 *A. B. A. Jour.* 815; John J. Coniff, "Industrial Peace", 31 *W. Va. L. Q.* 35; William R. Eaton, "The Industrial Law of Colorado", 97 *Cent. L. J.* 3; Ralph Fuchs, "Collective Labor Agreements in American Law", 10 *St. Louis L. Rev.* 1; W. M. Geldart, "The Status of Trade Unions in England", 25 *Harv. L. Rev.* 579; Robert L. Hale, "Labor Legislation as an Enlargement of Individual Liberty", 15 *Am. Labor Legis. Rev.* 154; James M. Kerr, "Union Labor Before the Law", 57 *Amer. L. Rev.* 239; John H. S. Lee, "Problems which have Arisen in Recent Labor Decisions in Illinois", 18 *Ill. L. Rev.* 77; John M. Matthews, "State Labor Legislation", 5 *Ill. L. Q.* 100; Calvert Magruder, "Labor Co-partnership in Industry", 35 *Harv. L. Rev.* 910; J. G. Pease, "Trade Unions and Trade Disputes in English Law", 12 *Colum. L. Rev.* 588; Lionel F. Popkin, "Judicial Construction of the New York Arbitration Law of 1920", 11 *Cornell L. Q.* 329; Murray T. Quigg, "Functions of the Law in Relation to Disputes between Employers and Employees", 9 *A. B. A. Jour.* 795; William Renwick Riddell, "Labor Legislation in Canada", 5 *Minn. L. Rev.* 83, 243; Ira B. Rosenblum, "The Use of Injunctions in Labor Disputes", 4 *St. Louis L. Rev.* 18, 78; Walter H. Saunders, "A Review of Recent Decisions Affecting Labor and Employment", 15 *Georg. L. J.* 361; Francis Bowes Sayre, "Inducing Breach of Contract", 36 *Harv. L. Rev.* 663; W. A. Shumaker, "Trade Unions and the Law", 22 *Law Notes* 107; Sidney Post Simpson, "Constitutional Rights and the Industrial Struggle", 30 *W. Va. L. Q.* 125; Horace Stern, "A New Legal Problem in the Relations of Capital and Labor" (on contracts between employees and a labor union not to work for two years in non-union shop), 74 *U. Pa. L. Rev.* 523; Joseph D. Sullivan, "The Supreme Court and Social Legislation", 10 *Georg. L. J.* 1; William H. Taft, "Workmen's Combinations", 18 *Law Notes* 69; Charles Thaddeus Terry, "Law and Order in Industrial Disputes", 9 *A. B. A. Jour.* 115; Everett P. Wheeler, "Injunctions in Labor Disputes and Decisions of Industrial Tribunals", 8 *A. B. A. Jour.* 506; Edwin E. Witte, "The Doctrine that Labor is a Commodity", 69 *Ann. Amer. Acad. Pol. and Soc. Sci.* (no. 158) 133; "Early American Labor Cases", 33 *Yale L. J.* 825.

constitutional limitations, the Supreme Court has been often divided. The opinions disclose clashes of social outlook which have dictated alignments professedly on the meaning of words. Underlying the whittling process which has been applied to the several provisions of the Clayton Act has been the conception of barriers imputed to the Constitution. These conceptions when analyzed are seen to be the conceptions of the individual conceivers who have felt more keenly the damage wrought by labor tactics than the damage wrought by the interposition of equity. Equity and the Constitution are majestic words, but he who is deceived thereby is not wise. Equity and the Constitution operate through the judgments of mortal men who chance at the time to be vested with judicial power. Under our constitutional system five mortal men wield a power which in many instances is nation-wide in reach. These men are not chosen by any plan which ensures that their judgments on vexed issues of social policy shall have an intrinsic superiority over contrary judgments. As the divisions in the Supreme Court reveal, important issues of policy depend for authoritative adjudication upon the chance of the outlook and the temper of a majority of the members of the Supreme Court at the time when the issues arise. Quite aside from the question whether in the adjudications thus far made the preponderance of wisdom has been on the side of the majority or of the minority, there remains the question whether it is wise to have such questions receive their final answer from so small a number of fallible, finite men.

This question also, I take it, is academic, from the standpoint of any change in our constitutional system. I see no warrant in American political history for any prophecy that the power of the Supreme Court of the United States will some day be curbed. Minority views may some day become majority views, but this erosive process is not likely to be precipitate. Meanwhile government by injunction, as its enemies are wont to term it, has a secure place in the law. As a process of determining individual disputes, it leaves much to be desired. There is something fantastic about a process of dealing with strikes and boycotts that entrusts arbitrament to the possible error of an individual judge that may remain regnant error long enough to wield determining power on the scene of action.

One who reads the fervid opinions of not a few of the trial judges must wonder whether the writer was in any mood to hear evidence objectively and to decide dispassionately. The evils in our present procedure must be apparent to all. The evils that the system seeks to prevent are also apparent. Strikes with violence or with intimidation are not intrinsically lovely things. Boycotts directed at those not privy to the dispute which animates them are not greatly to be desired as an end in themselves. We are in a kingdom of evils where the problem is to choose the lesser of the two or to acquire from other kingdoms some other measures of amelioration that may yield a greater victory of good over evil than the measures which now prevail.

Railing at injunctions will not end their reign. They have not developed out of an absence of all need for control of the conduct of industrial disputes. Whether that control must be by public authority or whether it can be instituted by advance agreement of prospective possible disputants is a question that cannot be answered until privately instituted systems of control have shown a satisfactory standard of effectiveness. The problems are not ones in which lawyers and judges are experts. They are problems, not for debaters, but for experimenters. With the wisest judges in the world, the machinery of the law would still remain inadequate for creative contributions to the enterprise of adjusting the conflicting ambitions of those who pay for work and those who work for pay. The contributions of the Supreme Court cannot be neglected, for behind them lie the instruments of power. The power of the courts must be reckoned with in any approach to the problem, but the problem may be to develop devices so that this power need never be invoked.

INJUNCTIONS AND LABOR DISPUTES

T. YEOMAN WILLIAMS

Secretary, The League for Industrial Rights

THE condemnation of the issuance of injunctions in labor disputes is periodic. No one has any desire to stifle such condemnation. It serves the extremely useful purpose of focusing attention upon the intricate problem of regulating industrial warfare without retarding the advancement of industrial justice. Such criticism also calls for a revelation of those basic principles of judicial procedure which are of the highest value for individual and social well-being. We can only ask that the issue be clarified by verifiable statements of fact.

The source of the objection to the use of the injunction in labor disputes is in the leadership of organized labor and in the ranks of those who sympathize with the aims and objects of organized labor. While this does not in any sense invalidate the objections, it does mean that in meeting the implications of the issue we have to deal with the objections to the injunction which are raised by this group. It might be worth while as a preliminary to what we desire to emphasize to deal in a cursory way with some of the more outstanding objections.

In many discussions dealing with the issuance of injunctions in labor disputes, we are left with the impression that in the injunction we have a new legal device working in favor of the employer to the detriment of organized labor. We have to deal with such accusations as the abuse of judicial power by injunction judges, the alleged substitution of the law of equity courts for the law of the lower courts, and with other similar statements.

We must not allow ourselves to forget that the injunction is a means of applying the remedies of the equity court and that the procedure dates back to the reign of Queen Anne in 1708. As early as 1846 in the case of *Gilbert v. Mickle* there was a decision in this country by Lewis H. Sanford, Vice-

Chancellor of the State of New York, relating to a trade case, antedating a labor injunction in the United States and England. The court had before it an application for an injunction on the part of an auctioneer against a placard placed in front of the auctioneer's house containing the words, "Strangers, Beware of Fake Auctions." The grievance was picketing and placarding, and the court said:

It is clear to my mind that the obstruction of the complainant's place of business as detailed in the bill constitutes a nuisance against which equity under ordinary circumstances is bound to relieve. Any person whose trade is injured or impaired by such an obstruction may unquestionably recover damages at law or restrain a further continuance of the nuisance by an injunction from a court of equity.

We have here an excellent illustration of the early workings of the equity court. It demonstrates the power of the court to protect the right of men to utilize their property and conduct their business without unfair or unlawful obstruction from outsiders. In applying the remedies of equity to labor disputes, the purpose and power of the equity court have not been changed.

In a current issue of *Law and Labor* (p. 75) we have a concise statement of the principles upon which the injunction is issued in labor cases:

In order to procure an injunction, it must appear:

1. That the defendants are injuring or threatening to injure a property right.

2. That the remedy at law is inadequate for one of the following reasons:

- (a) That the threatened damage will be irreparable, either because the defendants will not be able to respond in an action at law, or because of the nature of the injury it will be impossible to measure the damages with reasonable accuracy.

- (b) That the injury will be continuous, thereby necessitating a multiplicity of suits at law.

Any person threatened with irreparable injury from continuing unlawful acts may, upon a showing that such is the case, have a temporary order enjoining the acts until the parties can be heard by the court. Upon the hearing, which can always be had within two or three days upon the demand of those who are enjoined, the defendants may contradict the statement of the plaintiff, and if it appears that the conduct of the defendants is not unlawful, or the injury is not irreparable, the injunction will be discontinued. Upon the hearing, the plaintiff

must maintain a clear preponderance of the proof. In many jurisdictions, the proof upon such hearing must be given by witnesses in open court. In other jurisdictions, it can be taken by affidavit. After such hearing, the court may, in its discretion, continue the injunction until the trial of the case. The purpose of all such injunctions pending the trial of the case is merely to hold the parties in statu quo.

These principles are time-honored and well established. They were clearly defined long before the modern trade dispute made its appearance. The doctrine has not been extended to the disadvantage of any element or group in the industrial world. Injunctions have issued on these principles for the protection of property rights since the days of Queen Elizabeth.

Again it is stated that injunctions are being issued with increasing frequency and volume in labor disputes. In the recent hearing on the Shipstead Bill (S-4182) the opponents of the bill filed with the Committee a list of cases arising out of industrial disputes, covering a period of twenty-five years, in which injunctions have been issued in state and federal courts. An examination of the list reveals that at least half of the cases occurred in state courts, and unfortunately many of the cases were so inadequately described as to be incapable of identification. I question very much whether any tabulation of cases would be of any value in determining the increase in abuses in the issuance of injunctions. The procedure is liable to act as a boomerang and may be in reality a measure of the extent to which organized labor is responsible for excesses in industrial disputes rather than an index of the increasing use of the injunction.

A clear check of the reported injunctions in New York State shows an average of sixteen per cent arising from industrial disputes. A similar check in the federal courts shows that of reported injunctions only twelve per cent arise out of industrial disputes, a percentage which certainly cannot be regarded as excessively high.

We are also meeting from this source of opposition with the repeated assertion that the labor of a man is in no sense of the word a property right, but is rather and solely a human right. The spokesman for the Weekly News Service of March 17 says: "The Labor injunction issue can be summed up in these two points: If business and labor are property, the labor injunction judge is right. If business and labor are human

relations, and have no connection with property, the labor injunction judge has usurped his powers."

We are left here with the repeated fallacy of the "either—or" philosophy. The problem is presented in the form of a dilemma, that the right to labor is either a human right or a property right, whereas in reality we are compelled to recognize that it is not one or the other, but both—a human relation and also a marketable commodity, the value of which is expressed in the excellence of the work from the standpoint of its human relation values and in the extraneous reward received for the service rendered from the standpoint of its marketable value. Surely no one would think for a moment of denying that the money which a man carries in his pocket is a property right subject to the protection of the power of the equity court; and his right to earn more money is also a property right to be equally protected.

Again, the spokesmen of organized labor for the past forty years have repeatedly sought to make it plain that they were not objecting to the issuance of injunctions *per se*, but rather to the abuse of injunctive power by equity judges, in other words, the interference by the courts with what they regard as the lawful acts of organized labor. Such utterances can mean only one thing: that organized labor is complaining not about the character of the remedies which lie in the issuance of injunctions, but rather about the operation of the substantive law of the land regarding what it declares to be lawfully right and lawfully wrong for officers and members of labor organizations to do. This, I think, clarifies the issue of the objection to the use of injunctions in labor disputes. We are not dealing primarily with an objection to the use of the injunction. We are dealing primarily with what the substantive law has declared to be lawful and unlawful.

On every occasion when this issue is discussed, a very large field of activities which the law recognizes to be lawful is left entirely out of account, while the demand is made that the activities which have been repeatedly declared unlawful should by statutory provision or immunity be declared to be lawful. There is a pertinent paragraph by Justice Louis D. Brandeis of the Supreme Court, on page 26 of his volume entitled *Business*, which is significant in this connection:

You may compromise a matter of wages, you may compromise a matter of hours—if the margin of profit will permit. No man can say with certainty that his opinion is the right one on such a question. But you may not compromise on a question of morals, or where there is lawlessness or even arbitrariness. Industrial liberty, like civil liberty, must rest upon the solid foundation of law. Disregard the law in either, however good your motives, and you have anarchy. The plea of trades unions for immunity, be it from injunction or from liability for damages, is as fallacious as the plea of the lynchers. If lawless methods are pursued by trades unions, whether it be by violence, by intimidation, or by the more peaceful infringement of legal rights, that lawlessness must be put down at once and at any cost.

Likewise industrial liberty must rest upon reasonableness. We gain nothing by exchanging the tyranny of capital for the tyranny of labor. Arbitrary demands must be met by determined refusals, also at any cost.

We cannot refrain from asking just what it is that organized labor would like to make lawful through the restriction of the use of the injunction in labor disputes. For convenience, I quote a pertinent summary of this point from a current issue of *Law and Labor*:

Should trade unions have the right to break their collective agreements?

Should they have the right to wage war on neutral parties?

Should a trade union have the right to inflict punishment on any member who handles open shop materials when the purpose of that enforced refusal is to compel the open shop to go out of business, or sign a contract that it does not want to sign?

Should a trade union have the right to inflict punishment on any member who exercises his lawful right to buy anything he chooses, in any store he chooses, if by chance he buys anything from a merchant who sells some particular article that does not carry a union label, when the purpose is to drive that article out of the markets to the ruin of the wage-earners and investors who make it?

Should wage-earners who lawfully quit their work in a body, because they are not satisfied with the terms of employment, have the right to threaten physical injury to any man or to members of the family of any man who may be satisfied to work where the wage-earners quit?

Should wage-earners, having lawfully exercised their right to quit work, because they are not satisfied with the employment, have the right to misrepresent to the public the terms of employment offered them and the products of their former employer, in order to drive away members of the public who might otherwise deal with him?

Should trade unions have the right to strike against railroads or utilities because without discrimination they serve non-union men and open-shop products?

Through the issuance of injunctions in labor disputes we are primarily concerned in preventing industrial warfare from becoming an instrument of industrial injustice. The problem is one of law enforcement. It affects the basic rights of employer and employee in its effect upon the right to conduct business and the right to work without interference from voluntary aggregations of men. It concerns itself with the problem of winning respect for those prevailing inhibitions against anti-social conduct which have become clearly defined and definitely protected by law—inhibitions which business institutions and private citizens are willing to respect, but which to organized labor offer definite barriers to the accomplishment of its aims. Labor says: "Set us free from the power of the injunctive processes, and we will regulate our own conduct", while the believers in the injunctive process affirm that this process is necessary so long as labor organizations persist in doing unlawful things which the substantive law of the land time after time has declared to be illegal.

We do not think that in advocating the use of the injunction and the protection of the courts we can solve all of the many problems which are involved in industrial conflict. We do feel, however, that through an impartial application of the law to the unlawful elements in both capital and labor we have been able to maintain a condition which has been a safeguard to those experiments in industrial peace which in the last analysis are the concern of all forward-looking men.

DISCUSSION—INJUNCTIONS AND FACT-FINDING IN LABOR DISPUTES

MR. MORRIS HILLQUIT (lawyer, member of the National Executive Committee of the Socialist Party): The subjects so interestingly discussed in the forenoon have one feature in common, namely, they all relate to methods of settling labor disputes; but there their kinship ends. The methods of fact-finding and of impartial adjustment of labor disputes are aids to the process of collective bargaining, while the method of the injunction is destructive of it, and it is this distinction that determines the rôle and place of these methods in the struggles of labor for material improvement. For, after all, the success or failure of these struggles is determined by the bargaining power of labor.

There is nothing mysterious in this formula. The jobs of the country are largely concentrated in the hands of a few powerful industrial concerns. The individual worker is absolutely powerless to deal with such concerns on terms of equality. It is preposterous to speak as we do of the labor contract between, say, an individual steel worker and the United States Steel Corporation, an individual automobile worker and the Ford Company or the General Motors Corporation, or an individual railroad worker and the Pennsylvania Railroad Company. The only way in which labor can meet organized capital in the labor market on terms of relative equality and actually bargain for terms of employment is by collective and organized action. If the trade union controls the supply of labor power in a certain industry to about the same extent as the trust or association of employers controls the jobs in the industry, then, and then only, will they sit down and discuss terms and strike a fair arrangement for both sides. So long as the union is weak, it will not be even recognized by the employers, as a rule, to the extent of opening negotiations for collective agreements; and even when collective agreements have been made, they do not execute themselves *ex proprio vigore*.

In other words, the conditions of labor are in the last analysis determined by the strength of the labor organization and its liberty of action, including the right to strike. It is in this field that the injunction is fatal to the labor movement and to labor standards, for the injunction sets aside the rights which are commonly recognized as being enjoyed by the workers.

Within the last twenty years, and particularly within the last ten years, injunctions in labor disputes have become so frequent in number, so sweeping, and, I say it deliberately, so indiscriminate in scope and terms, that there is practically no labor dispute of importance that is not accompanied by the issuance of an injunction. Mr. Williams has cited some figures which I must frankly confess I did not quite understand, to the effect that labor injunctions constitute only 16 per cent of the injunctions reported.¹ The reported cases mean absolutely nothing. I can tell you from my daily experience that injunctions are practically as frequent as strikes. In a majority of cases they very seriously hamper the legitimate activities of the trade unions, and in a great many cases they thoroughly paralyze such activities.

When Mr. Williams asserts that the injunctions do nothing but prohibit illegal acts which the workers cannot and do not claim to have the right to commit, he tells only one side of the story.² I have known of injunctions that have prohibited legal acts as well as illegal acts, prohibited strikes as such. A strike is a species of industrial warfare. To tie the hands of one of the combatants while the other is allowed complete freedom of action is not maintaining the status quo. It allows the employer to proceed with all his preparations to break the strike and does not permit the worker to resist it. It is as if, in an actual war between nations, we were to suggest that one belligerent cease activities for a few weeks or months, while the other proceeds with full force, and then say that we have maintained the status quo on the battlefield.

The workers feel—and I think they have a good right to feel—that the whole field of labor injunctions is a species of class justice. It is perfectly idle to say that it is no more than

¹ Cf. *supra*, p. 80.

² Cf. *supra*, p. 81.

an extension of the ordinary and long-recognized equity powers of the court. Injunctions in labor disputes are an innovation. That unfortunate auctioneer in 1846 had nothing to do with it. No labor injunctions were issued in this country until 1848. The regular practice of issuing labor injunctions began in the Federal Courts in 1892. They have been increasing in number ever since.

It is also idle to say that they operate impartially. For every injunction issued at the instance of labor against employers, hundreds are issued against workers at the instance of the employers. That ratio obtains, naturally, because the situation is such that an injunction means nothing, or very little, if directed against employers.

Mr. Williams asks the question: What substitute can be proposed? Shall labor be allowed to indulge in those excesses which are characteristic of the strike, or should such excesses be restrained? I must make the observation that labor as a whole, as a class, has not shown itself more lawless than, for instance, the capital or banking interests as a class. But what do we generally do with people who are inclined to break the law? Do we issue injunctions against them? We wait until they have committed their excesses and then the arm of the criminal law is strong enough to reach out and to find them; and so is the arm of the civil law. Organized labor is the only class that is prevented in advance from committing a threatened or an imaginary excess or crime and incidentally from performing those functions which theoretically it has a full right to perform.

A very interesting reference has been made by Professor Powell to injunctions that have been issued, say, some seven years earlier and thereafter have been held by the highest court to have been erroneously issued.¹ The law has been vindicated, the principle has been correctly established, but the strike has been lost in the meantime. That is precisely what is happening with injunctions every day of the week. An injunction is issued without hearing, without notice to the other side. The preliminary injunction is issued *ex parte* on papers submitted by the plaintiff. With all due respect to the courts of this state and to the federal courts, I venture to say

¹ Cf. *supra*, pp. 54-55.

that in a great many cases these papers are hardly read by the judge. The clerk passes upon the general sufficiency; the judge signs the injunction. The application for continuing the injunction will not come on for argument and not be determined in less than perhaps two or three weeks, and sometimes longer. Meanwhile the hands of the workers are tied, without a hearing. I venture to say that only one out of fifty or perhaps one hundred labor injunction cases comes to trial. In most cases the preliminary injunction, the *ex parte* injunction, without notice or hearing, has decided the fate of the strike.

My conclusion, therefore, is that the method of fact-finding as a means to a peaceful, impartial adjustment of labor disputes will never develop in this country so long as the employers are given an easy way of settling their disputes with the workers not on the basis of facts, not on the basis of justice, but on the basis of their ability simply to forbid any kind of strike against them. If we wish to introduce in this country, as in England and in other progressive countries, a more civilized method of warfare and adjustment of disputes between capital and labor, labor and capital must first be placed on a basis of equality, of which the injunction deprives the workers in this country.

MR. MURRAY T. QUIGG (of the League for Industrial Rights, editor of *Law and Labor*, 165 Broadway, New York City): In February I ascertained from the clerk of Part I in New York County, where the *ex parte* orders are issued, the fact that during the calendar year 1927 only 133 injunction orders were issued without a hearing, in all types of injunction cases, and less than 5 per cent of these related to labor injunctions, whereas in the part of the court where motions come on on notice, there were over 51 motions for an injunction in all types of cases heard in one month. Assuming the same ratio of labor cases in that court, we may conclude that those brought on without hearing are exceedingly few in number as compared with those that are brought on on notice of hearing; and the showing, which must be made to the court, of necessity for immediate relief in cases where an injunction is issued with an order to show cause, must be very strong. The order to show cause brings the case on the calendar within three days

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and the delay in hearing depends upon the action of defendants. Of course it takes defendants in some cases four or five days, maybe a week, to prepare their defense. In a great many cases they do not even attempt to prepare their defense for two or three weeks. They do not move as rapidly as they might.

In some jurisdictions an injunction is issued *ex parte* and the defendant moves for a hearing on two days' notice, or in some instances he may never move, as in the case of one of the coal injunctions outstanding now, and yet it is charged that the defendants have been tied up for an indefinite time by an injunction on which they had no hearing. They might have had the hearing but they did not take the opportunity.

Professor Powell implied that the Supreme Court of the United States had given the Clayton Act a meaning entirely different from that intended by Congress.¹ As a matter of fact, the debates show that there was some dispute in Congress as to what it did mean; the Congressmen were not clear; several of them did inquire, on the floor, of the men reporting the bill from the committee, as to whether it was intended by the committee that the law should legalize the secondary boycott, and members of the committee said that it did not legalize the secondary boycott. If it had been intended that the act should legalize a refusal of any wage-earner to work on any product manufactured anywhere by any manufacturer, it would have been easy to say so, it would have been easy to say that this applied to disputes between any and all wage-earners and any and all capitalists. That is the interpretation which labor seeks to put upon the act, but it is not what the words of the statute say. The statute uses the term "employer and employee," and those words imply a definite personal relation between two definite persons. They do not imply a class.

MR. JULIUS HENRY COHEN (lawyer, 76 Trinity Place, New York City): It may be helpful to the reader of the record of these Proceedings if a brief reference is made to the attempt now being made by the Committee on Commerce of the American Bar Association, of which Mr. Rush C. Butler is the Chairman. The Committee held public hearings a month

¹ Cf. *supra*, p. 37 *et seq.*

or so ago, and expects to make a report to the Seattle meeting of the American Bar Association in July.

It is the purpose of the Committee to encourage the voluntary ascertainment of the facts, the voluntary settlement of controversy in industry, and the voluntary making of rules for the government of industry, and to remove such obstructions and anachronisms in the law as may now prevent the accomplishment of such results. In addition, the Committee will recommend the creation of a Federal Industrial Council which shall be representative of labor, of business as such, of management in industry, of agriculture and of the bar, this Council to have no power to make decisions or awards but to be continuously studying the problems of industry and to make recommendations to Congress and to the public generally.

It must be clear to the impartial observer that the truth of every situation is not to be found in the statements made by the advocates of one point of view or of one policy alone. As the two blades of the shears must be always brought together to be really incisive, both sides of a controversy must be heard before the truth is ascertained. It is ascertained today in conflict, not in conference. It is ascertained today in a warlike spirit, instead of in an atmosphere receptive to constructive work. It is our hope that such a Federal Council, being representative of various groups, will be able to present the truth as each sees it, and that out of the harmonization of the partial truth of all parties will come something approximating an American policy.

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PART III
TRADE UNIONISM AND EMPLOYEE
REPRESENTATION PLANS

TRADE UNIONISM AND EMPLOYEE REPRESENTATION PLANS¹

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I HAVE just been reading an interesting book on the labor movement in Japan. In that country large-scale machine methods of production are displacing small-scale handicraft industries as rapidly as anywhere in the world, but paternalistic relations between employers and employees still persist. As a consequence it is not unusual for employers to contribute even to the strike-benefit funds of their employees. This is in the belief that the employees are striking because they are led astray by designing labor agitators, and should not lack for the necessities of life until they are brought back to a realization that their employers are in reality their best friends and that loyalty to them is their highest duty.

We have long passed this stage in the United States. American employers often think also that their employees are misled by designing agitators when they go on strike, but I have yet to hear of one who contributes to the employees' strike fund! The gulf separating employer and employee has become too wide to permit such a gesture. Instead of mollifying the strikers it would only add to their suspicion and bitterness. This widened gulf between employers and employees opposes a serious obstacle to the further industrial progress of the United States. Instead of considering the employer as their best friend, American wage-earners have too frequently come to view him — "him" meaning usually a large corporation — as an exploiter of their labor power concerned only about profits. In consequence American strikes are more than temporary interruptions of normally peaceful and harmonious relations. Too often, as in the bituminous coal industry in Western Pennsylvania at the present moment, they

¹ Preliminary remarks by Professor Seager as presiding officer at the Second Session of the Semi-Annual Meeting of the Academy of Political Science, April 11, 1928.

have all the aspects of bitter and uncompromising warfare. How to bridge this gulf and substitute a truly cooperative spirit for the contentious and hostile attitude so often in evidence is the most difficult problem that confronts American employers.

It is a commonplace of economics that the interests of employers and employees are to some extent identical and to some extent opposed. They have a common interest in the financial success of the industry with which they are concerned. Unless it is profitable, the employer cannot long continue to pay wages, and the rates he will pay depend very much on the degree of profitableness. Had not the Ford Motor Company made profits on an unexampled scale it would hardly have begun the experiment of paying higher wages than other automobile manufacturers, nor tried the five-day week, while others operated on a six-day schedule. On the other hand it is equally certain that when it comes to the determination of wages and working conditions the interests of employers and employees are usually opposed. Other things being equal, the employer is benefited if he can get equally efficient labor for lower wages; the employee is benefited if he can get higher wages for the same expenditure of effort. This opposition of interest may be disguised but it is rarely absent. It may have been to Henry Ford's advantage to introduce the five-dollar minimum wage when he did, though other motor factories were paying substantially less, because it enabled him to attract the most efficient workers to his plants. It certainly would not have been to his advantage to have put in the present six-dollar minimum at that period of lower wages, though this would have been to the advantage of his employees. In spite of variations in detail it remains generally true that an increase in wages cuts into the employer's profits and is reluctantly granted, however advantageous it may be to the employees to receive it.

Employers like Henry Ford believe that the best way to harmonize the interests of employers and employees is for the employer to fix wages and working conditions above those in competing plants and then to organize the methods of doing the work so that these wages will be earned and a substantial profit left to the employer. But obviously all employers can-

not pay wages above those paid by other employers! Many find it difficult to pay even as much as their competitors and retain any profits for themselves. As a general formula some other plan must be found for advancing the interests which employers and employees have in common and adjusting in a fair way those which conflict.

Without anticipating unduly what will be said by later speakers, I think I may assert that there is a growing consensus of opinion that as a stimulus to effort no plan of profit-sharing, gain-sharing or bonus or premium payments, appealing to the cupidity of the worker, will take the place, in the long run, of a feeling of mutual confidence and good will between employer and employee. How to develop and maintain this feeling is the crux of the problem of industrial relations.

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EMPLOYEE REPRESENTATION—A WARNING TO BOTH EMPLOYERS AND UNIONS

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TO those who have heard the clamor in the ranks of organized labor against the menace of company unions, any warning to the labor movement, on this occasion, of dangers that lie in employee representation may seem quite superfluous. And remembering that employee representation is a considered policy of open-shop employers and management associations, it would seem equally superfluous to warn employers of dangers to them that lurk in the representation movement; especially when the wailing in the camps of the trade unions points to the evident success of their non-union representation policy. Nevertheless, an objective study of employee representation as a rival of American trade unionism reveals that neither the unions nor the employers fully realize the significance of the representation movement that has grown so spectacularly during the last ten years in the unorganized industries of the United States.

To sum up the misconceptions of both the unions and the employers in a paragraph is, of course, impossible. But it is well to start with such a summary in order to get the outline of the field of battle laid out for the trade unions by company unionism, as the employee representation movement is popularly known. Later we can fill in the details with modifications and explanations to make the picture clear.

On the employers' side the outstanding conception of employee representation that one finds reiterated again and again in the preambles to representation plans and in the literature and oratory of the subject is that employee representation is a device for restoring the close contact, cooperation, and friendly relations that existed between employers and employees when business was conducted on a small scale, and masters and men knew each other by their first names. At a

recent national conference on employee representation one of the conspicuous leaders in the movement pointed out that employee representation was merely a new and supplementary form of organization in industry designed to bring about friendly and cooperative human relations which the normal form of military production organization has proved inadequate to maintain. He deprecated the talk to the effect that employee representation is management sharing, industrial democracy, or a form of labor organization or collective bargaining, and maintained that employers who used these new phrases that have become current in industry were either ignorant or insincere.

Organized labor, on the other hand, ascribes all such talk to insincerity and will not even be charitable enough to ascribe it to ignorance. It coined the phrase "company union" as a term of reproach, implying in the very name an organization owned and controlled by the employer to suit his own purposes. To the trade unions, employee representation is an obvious fraud, a dishonest attempt to break the labor organizations, camouflaged with hand-picked representation to give the appearance of unionism. The terms employee representation, works-council, industrial democracy, cooperative plan, management-sharing are all held to be of the same counterfeit coinage as "Open Shop" and "American Plan," which an enlightened public will no longer accept to hide shops closed to union men and shops maintaining un-American standards and conditions.

There are individual industrial and union leaders who hold other views of employee representation than those here given. But that our summaries present the prevailing opinions among employers and unions will not be doubted by any one who has attempted serious study of the subject. It is our contention that these characterizations of employee representation, made by employers and unions themselves, will be found on investigation to reveal profound misconceptions of the results that the practical operation of employee representation plans is effecting.

And this is the warning that needs to be given to both camps—that they are confusing their notions of what they would like employee representation to be with what it actually is and

is becoming. The employers who think that employee representation is but a supplement to their management organization to insure cooperative and friendly labor relations without essentially changing the control of labor by the management, need to be warned that once an employee representation plan is launched, it tends to gather into the hands of the wage-earners more and more power and control over industry. It tends to become a union, adopting the policies and methods of trade unionism as well as organization forms and devices. If the employer, when he wakes up to this, attempts to balk this tendency he arouses opposition and a conviction among his employees that his pretensions of giving the workers a voice in industry were really insincere and dishonest. Conflict inevitably results, sometimes culminating in strikes and picketing exactly as with unions. If, on the other hand, the employer desires to avoid these results, he must make more and more concessions to the employees' organization, thus maintaining peace, but fostering a growth of power in the workers' organization.

The trade unions similarly need to be warned that the managers who sponsor employee representation plans are not the insincere, dishonest men with ulterior motives that they are made out to be. Some, no doubt, are of this character, as some labor leaders are. But to condemn a movement like employee representation which has world-wide manifestations, on the ground that it is but the result of dishonest industrial leaders, is about as intelligent as the condemnation of trade unionism on the ground that it is brought about by crooked labor leaders and designing "outside" agitators. The warning that organized labor must take to heart is that in the last six or seven years the unskilled and semi-skilled wage-earners of this country have secured more of the real results that trade unions are supposed to give them through the employee representation plans than they have through the organized labor movement. Not that they could not have obtained the same things through the labor organizations if the latter had been alive to the needs and efficient in handling the problems of the craftless workers in the mass-production industries. But the reason employee representation has grown so spectacularly is because the trade unions have failed to do their job among

the specialized workers in the large-scale industries. There is even evidence that these workers sometimes deliberately prefer company unions to the regular trade unions. With these facts available for all who wish to see them, organized labor will have to face them and develop new policies for dealing with them. Mere condemnation of employee representation as a fraud and a snare will accomplish little in this direction.

Before proceeding to outline some of the evidence in support of these warnings and conclusions, it is well to clear up any ambiguities as to the meaning of employee representation. In an all-inclusive sense the term is sometimes used to cover all forms of experimental schemes for improving labor relations, including trade-union arrangements with employers, profit sharing, employee stock-ownership, membership on boards of directors, as well as works committees and shop councils. In a narrower sense the term includes only such committees, councils, assemblies, or other forms of representation, as are established without the assistance of trade unions. It is in this narrower sense that the term employee representation is used in the present paper, and we are excluding from consideration also representation on boards of directors and profit-sharing plans. Our discussion is limited to those representation plans that refuse to recognize trade unions as legitimate intermediaries for the employees and are commonly designated as "company unions."

To a disinterested scientific student of labor relations one of the most significant facts about these company unions is that managers and business leaders have organized them avowedly as a means of providing democratic control over wages and working conditions, and that they urge the adoption of employee representation as a step toward industrial democracy. There are, of course, many employers and managers who merely follow the crowd and adopt representation plans and talk about industrial democracy without knowing what they are doing or saying, simply because it is the latest style in labor relations. The significant thing is that the really intelligent leaders, who have carefully studied employee representation and who are responsible for setting styles in management devices, should acknowledge the need and attempt to devise the administrative machinery for democratic control of industry.

Listen to what Mr. P. W. Litchfield, President of the Good-year Tire and Rubber Company, has to say :

It is our problem . . . to Americanize industrial management. We have all heard about Americanization and many of us think that it applies only to the individual, but when you Americanize the individual and he makes an analysis of his form of government in industry, and finds that it is not Americanized also, you are going to have more trouble than when you started, unless it is Americanized. Management in that sense is the same as government. In other words, it is a selected body to govern in the interests of all, keeping in mind that it should govern in the interests of the majority.

Henry Dennison writes :

It may be questioned whether there is the difference between the fundamentals of the problem of industrial management and the problem of political management that some of us think there is. Some of the experiments that are being worked out in industry, even if they seem unsuccessful for a time, must nevertheless rank as experiments in the management of men on a non-autocratic basis. . . . The technique of democracy—how to manage ourselves as citizens—is not very different from the problem of how to manage ourselves as parts of a producing or distributing agency.

Edward Filene :

Labor . . . having experienced the advantages of democracy in government, now seeks democracy in industry. Is it any stranger that a man should have a voice as to the conditions under which he works than that he should participate in the management of the city and the state and the nation? If a voter on governmental problems, why not a voter on industrial problems?

General Atterbury of the Pennsylvania Railroad has used words to the same effect. In speaking of the Pennsylvania plan of employee representation, he has said that there can be no fair play, no square deal, unless it is reciprocal. One side by itself cannot play fair. Management in most industries is organized to handle matters from the point of view of capital only. The viewpoint of labor ought to have equal weight. And he expressed the opinion that the workers' representatives, *together with* representatives of capital, should constitute the personnel department.

You may discount such utterances as being mere talk or advertising or general Buncombe, given out for public consump-

tion and not really intended to be put into practice. The mere fact, however, that employers and organizers of great capitalistic enterprises find it necessary or desirable to talk industrial democracy and to advocate its establishment as an essential principle of sound management is itself of the utmost significance. For something like a hundred years the term industrial democracy has been a familiar one in the propaganda of socialists, trade unionists and various kinds of social reformers. Now the leaders of business have taken it over. Why have they done that?

Apparently, it is because they are enlightened industrial monarchs. They have seen that treating laborers as if they were commodities is unsound and wasteful economically. They have tried paternalism or benevolent autocracy, and they found that this did not work, just as Frederick the Great and his followers found that benevolent political despotism did not work. But suppose it were true that all this talk of government and democracy in industry really is insincere. What then? Does it really make much difference what the talk is about economic institutions and mass human movements? The important thing is to look at employee representation in actual practice, to observe its operations, record and study them carefully, and determine thus objectively what its relation to democracy in industry is, regardless of what people say it is and regardless of what the employer who established it thinks it is or ought to be or intended it to be. Once they are created, human organizations of this kind have a way of evolving according to laws of their own nature in quite unforeseen directions. Those who speak insincerely of industrial democracy may be speaking better than they know.

Some evidence as to the direction in which employee representation is leading appeared at the Convention of the National Personnel Association (now the American Management Association) held in Pittsburgh in 1922. The Convention was discussing the Pennsylvania Railroad's company unions, which have been much in the limelight before the Railroad Labor Board and the United States Supreme Court. Mr. Garrett of the Personnel Department of the Pennsylvania Railroad had presented General Atterbury's ideas. He then introduced a Mr. Bate, who was chairman of the company union,

elected by the employees. This is what Mr. Bate said: "General Atterbury has put something in the field that he would have a hard job to take out, and we have gotten so far we say this—we dare him to take it out."

An investigator of one of the Standard Oil Company's representation plans reports his conversations with representatives of the workers elected under the plan as follows. They told him: "The quickest way to start a strike in a refinery . . . would be to abolish the plan of representation."

That these are not merely idle threats is shown by the investigations of works councils made by the National Industrial Conference Board. The report cites some cases in which strikes actually resulted from attempts to abolish representation schemes. And I am told that in one New Jersey city, after the Standard Oil Company had inaugurated its plan, the employees of a competing oil company threatened to strike unless their employers inaugurated a similar scheme; and the management was forced to install a representation plan.

Whatever the motives of the management may be, when it inaugurates employee representation it is handing the employees a constitution for the government of the industry. It may not be much of a constitution. It may give the wage-earners little power, few rights, and the management may think that employee representation is different from unionism because it does not provide for the right to strike. But that is quite immaterial. The management has started a movement in the direction of democracy in industry which is bound to grow. Just as the first political constitutions of European countries did not provide much democracy but gradually led to more and more democratic control by the people, so these employee representation plans may not have much democracy in them at first, yet it is inevitable that once a plan is established the workers will get more and more control over it. In the report of the National Industrial Conference Board on the works councils you will find a section entitled "Growing Power of the Councils." The Board's investigations revealed this trend and its reports cite many facts and cases indicating it.

The notion, then, that professions of industrial democracy may be insincere, or that those who establish employee repre-

sentation do not believe in democracy and do not intend to have any of it, is quite immaterial. The question is rather whether forces of self government in industry have been let loose which tend to give wage-earners more and more power and control over industry. The fact that workers threaten strikes when managers propose to use their undoubted legal right to drop representation plans, that they dare the employers to take the plans out, and that sometimes they strike to get plans inaugurated, are all straws showing the direction in which the wind is blowing.

A statement often heard among employers and managers is that trade unionism is based on force while employee representation is based on cooperation, and therefore the latter is to be favored and the former condemned. This is but the counterpart of the notion that organized labor has that company unions are bound to be ineffective because they cannot back up their demands with strikes. When we look at the situation as it exists in reality, we find that employees in company unions have just as much right to strike as those in trade unions. Company unionism is no guarantee against strikes; and the experiences of the subway company in New York City, as well as the coal strikes in Colorado in which the employees of the Colorado Fuel and Iron Company have participated, ought to be sufficient evidence to cure both the employers and the unions of this naïve notion. One company—it has a plant in Brooklyn—is realistic enough to face the facts; and it has a provision in the constitution of its representation plan which reads as follows: "The right of the employees to strike in this plant and of the management to lock-out is not impaired by this plan."

True, a company union may not carry on a strike as successfully as a national trade union with a large treasury. But there are many trade unions as helpless as the company unions are in this respect. Employers must not be lulled into a false security by the notion that company unions do not strike. And the official labor movement of the country must not ridicule the weakness and discount the power of company unionism, or it may have a dual unionism on its hands which may turn out to be more effective than any it has yet encountered.

The idea that employee representation is merely a device for restoring the close contact and friendly relations which existed when business was small and employers and employees knew each other's first names is apparently confined to the ranks of the employers. No such notion seems current among the trade unions. But of all the thoughtless platitudes about labor relations, this is about the worst. Where did class conflict, strikes and all the other evils in relations between employers and employees originate? Was it in the large plants? It requires but little study of industrial history to learn that strikes, boycotts, picketing, blacklisting, and practically all of the other paraphernalia of industrial warfare, were developed at the end of the eighteenth century and in the early part of the nineteenth, both in England and in the United States, in the small handicraft shops that prevailed at the time.

Trade unions arose in small competitive industries. That was where the most unsatisfactory labor relations have always been found. It was true not only of the past; it is true today. Where are the most bitter labor conflicts always recurring? In the building trades, in bituminous mining, in the small shops of the needle trades where employers and workers know each other all too well! Experience as an arbitrator over a period of years, and in several lines of industry, has brought the worst labor relations to my attention and the most bitter conflicts to arbitrate come from the smaller plants where personalities cannot be distinguished from industrial policies. The large establishments, with standardized policies, will not countenance the mean tricks to which people will stoop when they know each other well.

Heaven appears to most people as existing in the past. Old times appear as good times. Employers and workers knew each other's names and lived together in brotherly fashion. Nowadays business is so big, employees are known only by their numbers. Yes—but when they knew each other by their first names and not by numbers, what names did they call each other? What kind of names? No, employee representation is not in practice a scheme to bring back the close touch and bitter feeling that existed between the small master and his few employees.

Another preconception that prevents employers and unions

alike from appreciating the true effects of employee representation on what they consider sound labor arrangements, is the notion that there is only one true method of arranging cooperation between management and workers, only one right method of allowing the workers a voice in industry. If employee representation is a sound cooperative method, then the trade-union method must be unsound and uncooperative. To organized labor, in the same way, it appears that if its principles are right, therefore company unionism must be wrong.

In actual practice, however, it appears that sometimes the most effective kind of management-worker cooperation and democratic control of labor relations is brought about by employee representation, sometimes by trade unions, and sometimes by neither of them. There is no one true form of industrial democracy, as there is no one true form of political democracy. Just as some ill-informed people think that America is the only real democracy, overlooking the equally good and sometimes more effective democracies of Great Britain, Norway, Denmark, Switzerland and Canada, so some employers think that employee representation is the only form of joining workers and managers in cooperative organizations, and most labor leaders think the traditional trade unions are the only proper form of labor organization.

But if employers investigated employee representation with the same scientific objectivity that their laboratories study chemical and mechanical problems, they would soon learn that there is nothing their representation plans have accomplished which had not been achieved by some trade unions many years before them. The representation plans work exactly like trade unions. Even when they start as mere advisory committees, they tend to become more and more like unions. They use the same methods and machinery of consultation and negotiation that the collective bargaining arrangements of the unions do. Their accomplishments are the accomplishments of organized labor. Their success measures the failure of the trade unions. Their failures measure the efficiency and effectiveness of trade unionism. If employers want to avoid collective bargaining and democratic control by the workers over terms and conditions of employment, they had better beware of company unionism.

On the other hand, if organized labor studied employee representation with some scientific detachment, it would find that workers sometimes prefer company unionism to trade unionism, because they think it secures for them what the regular unions have been unable to get. They may be wrong but they think employee representation is doing the unions' job. When they are convinced that the company unions can do little for them and that the trade unions will be more effective, they will prefer the trade unions. Recently, the manager of one of the large milk companies in New York stated his conviction that unless his employee representation plan gave the workers as much as they could get from a trade union, they would go over to the trade unions. This company's experience showed, also, that the representatives were not averse to using the threat that the company's business might go to competitors if work were stopped because cases were not settled as the workers thought they should be settled. If the aims of trade unionism have been to give wage-earners some voice in determining conditions, to treat the laborer as a human spirit, rather than as a commodity of trade, to fix wages on a give-and-take basis, to reduce hours of work, and to prevent arbitrary discipline and discharge, then these same purposes have in recent years been accomplished to a considerable extent by the employee representation movement. Organized labor is in danger of having its thunder stolen. The employers have learned to fight the union's fire with a fire of their own.

There is little time for supporting data here, but a few instances may be cited. The Philadelphia Rapid Transit has one of the most successful employee representation plans in existence. Yet its aims and methods and practices are essentially those of trade unionism. In fact, the Mitten Management wanted to begin its cooperative plan with the unions. It took two votes on the question whether the employees wanted the Street Railwaymen's Union to represent them, or a company union. Both times the employees themselves voted down the proposition to join the regular union. They voluntarily chose the company-union form when the management was willing to deal with organized labor.

They now have a collective contract which is exactly the

same as a trade-union contract. They have a dues-paying organization, joint committees, arbitration, collective bargaining and all the other forms and devices of trade unionism. This plan works and is successful because it is doing what the union should have done. And recently the Street Railway-men's Union agreed to let the company union arrangement stand in Philadelphia and Buffalo while the company agreed to unionize any other systems it may undertake to manage.

The Pennsylvania Railroad plan deals with and recognizes the Railroad Brotherhoods. It uses all the methods and machinery that the railroad unions have developed in fifty years of collective bargaining with the railroad managers. General Atterbury has publicly stated that he deals with practically 100-per-cent-unionized train crews, and his objection to the shop-craft unions and other labor organizations is mainly against their methods and management, not against union organization as such. On the other hand, Daniel Willard of the Baltimore and Ohio found the shop-craft unions on his road efficient, reasonable, and willing to cooperate. He, therefore, has union-management cooperation, while the Pennsylvania has employee representation.

Another example is the Sperry Gyroscope Company. That company worked out a representation plan and presented it to the employees who overwhelmingly voted it down. Two years later, however, the same employees came along with a plan of their own and presented it to the company, saying "Let us have this one." The management considered it, a vote was taken, and finally it was adopted. This company union, then, is the employees' own plan. What is the significance of that? To a disinterested observer it means that the managers of the regular unions were asleep. Here were employees who did not want the company's kind of employee representation. Had the union managers been awake and on the job, they might have gone to the employees and told them, "We will organize and operate the kind of representation that you do want." Then they might have established something like the Baltimore and Ohio plan. But they were asleep and the employees had to work out a plan themselves. The employees, therefore, keep away from the organized labor movement and have a company union. But what they are

trying to do is not essentially different from what the trade unions do.

In several employee representation plans, it may be added, the employees are required to pay dues, and in some they even have a closed shop. No one can work in the plant who does not belong to the company union. That is true of the plan of the Interborough Rapid Transit Company in New York. The Nunn-Busch Shoe Company of Milwaukee has a similar requirement, although its plan is far more favorable to the employees than is the Interborough Rapid Transit plan. This company and some of the mining companies that have employee representation, such as the Davis Coke and Coal Company and the Consolidated Coal Company, also have business agents or commissioners hired and paid by the employees' organization to deal with the management.

The significance of all this is that there is going on a competitive struggle for the leadership of labor between the managers of company unions and the managers of trade unions. The leaders of organized labor hardly seem aware that the competition is going on, while the leaders of the employee representation movement fail to realize how they are being led to concede the essential principles of trade unionism and to adopt the methods and practices of organized labor in order to keep the workers away from the trade-union movement.

In the one camp there are the ordinary labor leaders, most of whom learned their jobs in the bitter school of the small shop where the employer knew everybody by name. In the other, there are the increasing numbers of personnel managers and industrial relations directors who learned their jobs in Colleges of Engineering and Business Administration, where they studied labor psychology, industrial relations and scientific management. These two groups are competing for the leadership of labor in America and apparently the scientific managers and personnel directors are winning out. Trade unionism is losing in proportion as employee representation and the other devices of modern industrial relations management are growing in effectiveness. There is no danger of the trade unions' going out of existence entirely. But for the present, at least, they are more or less at a standstill, at bay, before the large-scale industries which are rapidly fortifying

themselves with company unions. It is in the automobile, electrical, steel, rubber, cement, rayon and similar industries, employing great masses of unskilled and semi-skilled labor, that the future progress of trade unionism must be made. But it is exactly in these industries that its progress has been stopped.

One reason for this situation may be that the unions have not the trained leadership the employee representation plans have in their industrial relations managers. The trade unions need trained leaders and scientific research men to aid them, such as modern personnel management is providing for the employers to lead company unions. In a way these leaders and researchers must be outsiders like the industrial relations experts who are brought in by employers from the outside to advise them in matters of labor management. These men asked new questions, and questions that seemed foolish to traditional labor managers. But that is how they learned to handle labor relations in new ways and how they developed the employee representation movement to balk the efforts of organized labor. When the trade unions learn to go outside their ranks in a similar way or to train leaders of the same kind, who will ask new questions about traditional union methods and policies and thus be led to improve them, then unionism may take a spurt again, and employee representation may not have as easy sailing as it has had up to the present.

OUR EXPERIENCES WITH EMPLOYEE REPRESENTATION

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THAT there should be disputes between management and workers is the most natural thing in the world, for both are humans, and humans do not all think alike, act alike, or want the same things. Having different viewpoints, we humans generally come to different conclusions. In my opinion, the only reasonably workable rule for obviating conflicting conclusions is to get the interested parties to view their problems from each other's viewpoints, and then from a point in between. That, in a nutshell, is the accomplishment of employee representation as exemplified at Armour and Company.

The practice of looking at things from the other fellow's viewpoint is not easily acquired. All of us like to think that we are reasonable and tolerant, but, in truth we are inclined to be pugnacious, and, in practice we lean toward fighting things out rather than reasoning them out.

In the comparatively short time since the inception of the present industrial age, there have been mighty conflicts between management and workers, and in most cases, reasoning was not indulged in until both sides had struggled to a point where physical or financial exhaustion made a compromise essential. The possibility that a way has been found to obviate this apparently natural antagonism is the reason for the widespread interest in the plan that has produced industrial peace in the meat-packing industry for six years past, and which promises to continue such peace in the years to come.

Before recounting our experiences with employee representation, let me describe the kind of soil we tilled and the seeds we planted so that you can evaluate the fruits of our efforts.

Standing as he does between the producer who wants high prices and the consumer who wants low prices, the packer is

compelled to operate on the lowest possible margin, and this affects the amount of money which is available for wages to the employees of the industry. Naturally, packing house employees want the best wages and the packer wants to pay the very maximum because of the quality and the efficiency of well paid labor. The possibilities are determined by laws of economics rather than by the views of the employers, for obviously when the packers cannot control the prices at which they buy livestock and cannot control prices at which they sell meat, they must make their operating margin cover their needs, rather than make their needs determine their margin. As a general proposition, wages in the packing industry have always approximated the wages paid for similar kinds of labor throughout other leading industries. It is difficult to compare work in the packing plants with work elsewhere. More or less skill is necessary, but, in a large plant it is the kind of skill which can be acquired in a comparatively short time. In certain operations the nature of the work is not particularly appealing, despite its essentiality. Even so, the industry attracts and holds an ample labor force at all times.

The packing industry has seen a most interesting procession of nationalities. In the early days, the employees were largely Irish, German and Scotch. Many of them belonged to an organization known as the Knights of Labor, which precipitated and was disrupted by a strike in 1886. After the settlement of this strike people of Polish extraction came into the industry in great numbers, and a few years later there was an influx of Bohemians. Another big strike took place in 1894, and with its settlement came another change in the nationality of packing-house employees. This time, Russia and southeastern Europe provided the workers. Many of them could not speak English; few of them were familiar with American customs. They were easily misled, misdirected and exploited by self-appointed leaders, and the early part of the twentieth century saw many disputes and much disagreement. Relations between the packers and their employees were anything but satisfactory.

This was the situation which prevailed when we entered the great war. The American meat packers were a much bigger factor in the winning of that war than most people realize.

You will remember that the slogan of the day was "Food will win the war". Food in itself could not have won the war without proper and adequate distribution, and it was the meat packers on whom the government had to depend for distribution. The industry knew how to process meats and had the equipment necessary for getting it to the places where it was needed. A constant supply of fresh and wholesome meat for the armies in France was as important as supplies of ammunition—and more difficult to deliver, because meat is perishable.

Under these circumstances, it was imperative that steps be taken to prevent any labor difficulties which might have interfered with the regular movement of meat supplies, and thus it came about that the government appointed an official mediator in the person of Federal Judge Samuel Alschuler, who was charged with arbitrating any grievances having to do with wages and working conditions which might arise in the industry. Judge Alschuler served in that capacity until the war was over, and although the war ended in 1918, he continued to serve until the fall of 1921.

With the end of federal mediation and arbitration in sight, Armour and Company took up this labor problem as it had never been taken up before, and with the employees worked out the details of a plan designed to aid in solving the age-old differences between employee and employer. It is this plan and the manner in which it has worked for some six years which I am to discuss.

The first move in the development of our plan was to ask the hourly paid employees to elect from among their own number representatives to sit in conference with the management. This group then studied various forms of machinery and plans used by other employers or industries, and after a week of constant sessions they jointly prepared the plan and drew up the constitution under which we are still working. It was not a plan drawn up by the management and handed to the employees to take it or leave it. Our plan represented at the time it was prepared and it still represents the joint thought and conclusions of both employees and management.

I will sketch very briefly the outstanding features of the plan which they adopted and which we now know as the Armour Employees' Representation Plan. The purposes of

the plan are stated as follows: to give the employees of the company a voice in regard to the conditions under which they labor, and to provide an orderly and expeditious procedure for the prevention and adjustment of any future differences, and to aid in the development of all matters of mutual benefit to the employees and the company.

Divisional Committees and Conference Boards are composed of equal numbers of representatives of the employees and of the management; the employee representatives are elected directly by the employees, by secret ballot, whereas the management representatives are appointed by the management—both at all times are to have equal voice and voting power in the consideration of matters coming before them. Divisional Committees have original jurisdiction in their respective divisions, namely, the beef division, pork division, production division and mechanical division. The Conference Board has general jurisdiction over the plant as a whole and is the appeal body from the Divisional Committees. On this board there is one employee representative for each two hundred employees in the smaller plants, and each three hundred employees in the larger ones.

Representatives of the employees must be actual employees of the company in that division of the business from which they are elected, and all hourly paid employees twenty-one years of age and over who are citizens of the United States and in the service of Armour and Company continuously for one year, are eligible to hold office. All hourly paid employees over eighteen years of age, both men and women, are entitled to vote, by secret ballot, provided they have been in the service of the company for thirty days immediately prior to election. The terms of office of employee representatives is one year. If the service of any employee representative becomes unsatisfactory to the employees of the precinct or division from which he was elected, they may recall him and elect someone else in his stead.

On all matters of dispute the employees are required to vote as a unit in accord with the wishes of the majority, and the management representatives likewise must vote as a unit. If it should become evident that employees and management cannot agree on a decision in any matter, provision for arbitra-

tion is made. This provision for arbitration is a backstop which absolutely insures the satisfactory adjustment of any problem. It is an evidence of the good faith of both the employees and the company and is a provision which we feel is necessary in any plan which really is what it claims to be.

These are but the highlights of the plan which goes into considerable detail in specifying the ways and means for meeting and solving disputes that might arise.

Any employee desiring to bring any matter before his Divisional Committee or the Conference Board may present it to the employment superintendent either in person or through his representative. If the matter cannot be adjusted by the parties directly concerned—usually the superintendent and the employee—it then goes to the Divisional Committee, and if this Divisional Committee cannot solve it, the plant Conference Board takes action. Matters of general or inter-plant interest go to the General Conference Board which meets on call in Chicago and which is, in effect, the Supreme Court of the Conference Board Plan.

The first meeting of the General Conference Board was one long to be remembered. This meeting was called to ratify the plan and arrange for its adoption in all the Armour plants. For the first time in the company's history, duly elected leaders of the plant workers sat opposite the management representatives at the same conference table. It was a new experience for both of them and they were nervous and skittish. They did not as yet know each other. They had not yet learned from experience that the best way to iron out grievances is to bring them out into the open for airing.

The Conference Board was cosmopolitan, particularly the employee representatives. Among them were common laborers and skilled mechanics, men with college educations and men with no schooling, white men and black men, white collars and overalls. In one respect, however, they were alike; they were men of intelligence and fair minds. They realized that if their conference was successful they would bring about a new relationship between employee and employer, and that they were charged with a heavy responsibility. They labored earnestly and diligently over the preliminary constitution and finally adopted the rules and regulations of the Conference Plan. These were later ratified by the employees.

The official announcement of the plan carried with it a letter from the late J. Ogden Armour, then President of Armour and Company, addressed to the plant worker. In this letter Mr. Armour said:

World events of the past few years demonstrated as never before that cooperation is one of the greatest factors in adjusting anything worth while. The meat packing industry has reached the point where there must be greater cooperation between employers and employees.

The directors of the Company have decided to establish a medium whereby matters of mutual interest to the employees and the Company may be discussed and adjusted. To properly exercise this function the employees must learn and recognize the responsibility that the business has to the public and its limitations in the matter of providing for the needs of both its owners and workers. The success of business is measured by its returns to owners and employees and by its service to the public. No business can be successful which does not serve all three. Disagreement means business failure; no dividends for the owners; no wages for the workers; no service for the public.

With a view of making real cooperation possible, representatives of the employees and representatives of the management have agreed upon the plan which is outlined in this accompanying constitution. In this, means have been provided for the prompt and orderly consideration of all matters of mutual interest such as wages, hours of labor, working conditions, sanitary and safety measures, etc.

Any employee who may be selected to serve in any capacity in connection with the operation of this plan, shall be wholly free in the performance of his duty as such and he shall not be discriminated against on account of any action taken by him in good faith in his representative capacity. The Superintendent of the Plant and the General Superintendent have been designated to see that this provision is carried out.

It is my firm belief that the cooperation which this plan makes possible will be of mutual advantage to employee, to employer and to the people whom we both serve.

This expressed the policy of the company in presenting the plan. Unfortunately, very soon after its adoption the Conference Board considered and agreed to a wage decrease. They agreed to it just as reluctantly as you or I would, with all the regret and dislike that such an action arouses in a normal human being. But they were convinced that it was necessary; that the business had retrenched in every other possible direction first, and the reduction of wages was only asked as a final measure after every other effort to reduce costs had

failed to accomplish its purpose. Of course, this action made the plan a target for certain leaders who had been more or less recognized as spokesmen for the packing house employees during the time of federal labor control, even though they were not actively engaged in the packing industry. These leaders called a strike in protest against the wage cut and some of the packing house employees responded, with the result that for a few days the operations of the plants were hindered. Just to indicate the response which the strike call received from the rank and file of our workers, I will cite the situation at Chicago. Out of a total working force of 10,523 people, there were absent from work on the morning of the strike just 352. The normal number of absentees runs about $1\frac{1}{2}$ per cent, so you can readily see that a great majority of the employees stuck by the Conference Board. The strike was of short duration.

It was recognized, however, that the success which attended reduction of wages through the action of the Conference Board was not the acid test. The Board had to demonstrate its ability and power to raise as well as to lower wages, and it had its opportunity in the course of the next year. When conditions seemed to warrant it, the employee representatives on the Conference Board requested a wage increase, whereupon the Board directed a survey of wages and conditions of work in comparable industries, to determine the true facts in these respects.

The survey was made by joint committees of employee representatives and management representatives. These men were given time off from their labors and furnished credentials which gave them entrée at such plants as they cared to visit. When they finished their survey, they recommended an increase of approximately 10 per cent and the Board adopted the recommendation and passed it on to the company executives, who made it effective.

Since that time, a survey of wage and working conditions in the vicinity of the large plants is a regular event each spring, and it is worth noting that on at least two occasions the employee representatives themselves declined to support a wage-increase request after their survey, without the matter coming to the formal attention of the Board.

Conditions over which the packing industry has no control complicate our labor situation and prevent steady and even employment. This is particularly true in the departments where killing is done and in those departments which handle the immediate output of the killing departments. Livestock comes to market at times without rhyme or reason. Some ten million farmers and livestock raisers ship when they see fit, and, as a result there are days when there are a great many more meat animals than the packing plants can handle, and other days when there are fewer than the packing plants require. This uneven receipt of raw material constitutes one of the big problems of the meat packers and tends to bring about irregular working conditions, which alternate lay-offs and overtime.

The Armour Conference Board has approved a plan which guarantees the workers pay for forty hours weekly. This is equivalent to five eight-hour days. An actual eight-hour day is practically an impossibility so far as the meat packing industry is concerned. In theory we have what amounts to a nine-hour basic day, and prohibitive overtime rates are so arranged that they permit the handling of heavy receipts, but with burdensome penalties. Every effort is made to provide at least forty hours of work each week, but the impossibility of so doing is evidenced by the fact that Armour and Company find it necessary to pay from three hundred thousand to five hundred thousand dollars per year to employees in the way of guarantees and excess pay for overtime.

After these big and absorbing problems had been settled to the satisfaction of employees and management, the Conference Boards gave attention to other matters and led the way in constructive effort along lines of interest to both the employees and the management. One of the greatest achievements of the Conference Board was in securing for the employees the privilege of acquiring ownership of stock in the company. As the result of a campaign directed by the Board, approximately 100,000 shares of stock, representing a par value of ten million dollars, were sold to employees in the plants. These employees are drawing dividends on that stock at the rate of about \$700,000 annually, and those who are closest to the situation predict that employees will purchase stock in ever increasing

amounts as the years go on and will in time own a very large share of the business which employs them. It is interesting to contrast this method of acquiring control of business with the methods advocated by certain radicals in foreign countries.

Another accomplishment of the Conference Board lies in the introduction of group life and health insurance, as a protection for plant employees. At the request of the Board, Armour and Company purchased a blanket policy with a great insurance company, providing \$1000.00 life insurance for male employees and \$750.00 for women employees. Each policy covers death from any cause and pays to the beneficiaries the face value of the policy. In case of total permanent disability, the full face value of the policy is paid to the employee in monthly installments while he is living. In case of sickness or non-occupational accident—the health-insurance policy provides for payments of \$10.00 a week to men employees and \$7.50 a week to women employees, up to a total of thirteen weeks, and provides in addition free services of visiting nurses. For this protection, male employees pay at the rate of 35 cents a week, and women employees at the rate of 25 cents a week. Armour and Company pay the balance of the net cost as well as all the expense of administration.

The Conference Board secured another substantial advantage for the people they represent—that of vacations with pay for plant workers who are on an hourly basis. In the past, vacations with pay were exclusively the heritage of salaried workers. Now, the hourly workers who have been in the employ of the company for five years are entitled to one week's vacation with pay, and those who complete fifteen years of service receive two weeks' vacation with full pay.

Constructive work has been done by the Conference Board along lines of accident prevention and the reduction of waste. Both of these are primarily caused by carelessness or thoughtlessness, and the Conference Board has promoted campaigns aimed to keep the minds of the workers on the alert. As a result, a very considerable reduction in the number and severity of accidents has been made, and we have noticed also a reduction in the losses occasioned by spoilage of product and supplies through careless handling.

The Conference Board has proved a medium for the de-

velopment of men. Employee Representatives on the Conference Boards have to win their places in elections. That requires them to demonstrate leadership abilities and to exercise and develop their abilities afterwards, for unless they give satisfaction to their constituents they are subject to recall.

Many of the representatives have impressed the management with their fitness for bigger jobs and promotions have resulted. Management representatives, too, have been broadened and developed by reason of the conferences that are an integral part of the plan. Nearly every plant superintendent agrees that employee representation has made supervision easier. Petty grievances which formerly occupied a considerable part of the superintendent's time are ironed out at their inception and without stoppage of work. The working force itself has greater stability than before, for jobs with Armour and Company now appeal to people who desire assurance of a square deal and of their day in court; with the special advantages secured by the Conference Board, the job becomes quite attractive.

Primarily, the employee representation plan was designed to solve the problems incidental to wages and working conditions, but with these adjusted and with the machinery existing for meeting new problems as they arise, the Conference Boards are able to give more and more of their time to constructive effort along less controversial but nevertheless highly important lines. In the six years during which we have enjoyed employee representation in our plants, we have come to believe that it is thoroughly practical and thoroughly satisfactory, both to employees and employers. Started as an experiment, it has demonstrated its practicability, and there is greater cooperation and better feeling today between the management of Armour and Company and the workers than has ever been the case before.

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UNION-MANAGEMENT COOPERATION IN THE RAILROAD INDUSTRY

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DESPITE the somewhat, gloomy picture my friend Dr. Leiserson¹ has painted concerning the present status of the organized labor movement, I wish to submit that, in the words of Lady Peele, "There is lots of life in the old girl yet". It is my task to describe the program of cooperation between unions and management in the railroad industry—an industry which I am glad to say Dr. Leiserson omitted from his list of industries in which the organized labor movement is not functioning effectively.

It should be pointed out in the beginning that the policy of cooperation between unions and managements in the railroad industry has not been designed merely for the purpose of settling grievances, in other words, adjusting the conventional differences which have troubled the relationships between men and management in the past. It is a program which is designed to further the major purposes of the industry, namely, service to society.

The cooperative movement in the railroad industry dates back to the period shortly after the war. At that time, and in recognition of the policy adopted by the Federal Railroad Administration, namely, that workers were not to be discriminated against for membership or non-membership in unions, the railroad unions conceived the idea that, as long as this matter of controversy was out of the way, they could rightly and properly offer their services to the management for the purpose of furthering the objects of the railroad industry. They drew up a program which was submitted to the Director General of Railroads. After the program was submitted, the railroads were returned to their private owners and then the period of liquidation set in, with the result that no practical

¹ Cf. *supra*, pp. 96-109.

progress could be made toward the establishment of a constructive relationship between the railroad unions concerned and the managements. The unions, nevertheless, insisted upon keeping the idea alive. When later the railroads proposed a reduction of wages as the only escape from the predicament that they were in, the unions suggested that the thing to do was for the unions and the managements to get together with a view to seeing what could be done in the way of eliminating the wastes and inefficiencies of the industry. That proposal, however, was not accepted.

Before the final crisis arrived in the post-war railroad labor liquidation, which took the form of the shopmen's strike of 1922, the shop organizations themselves had proposed to several railroad executives that something be done by way of cooperation between these particular unions and the managements. After the shop organizations had made this suggestion to two or three executives, they finally met with the President of the Baltimore and Ohio Railroad, who said that, as far as he was concerned, he would be glad to try out the idea of cooperation.

It so happened, however, that about that time the Railroad Labor Board saw fit to hand down another drastic wage cut affecting particularly the shopmen, with the result that the shop unions went out on strike. As soon as the strike was out of the way, in September 1922, the shop craft unions and the management of the Baltimore and Ohio again got together and decided they would put a cooperative program into practice. A point on the Baltimore and Ohio Railroad was selected, for purposes of demonstration, out in Pittsburgh, where the situation was particularly bad from the point of view of cooperation. The original theory was that the idea of cooperation between unions and management should be tried out in an atmosphere where results might be expected to be reasonably sure. The argument which the railroad company put up was that, "If you can make cooperation go in the Pittsburgh shops, it ought to go anywhere."

It was my particular task to go out to Pittsburgh and try to put the program into practice. I lack the time now to paint a picture of what was found out there. There were racial differences. The local management looked upon the

unions as a sort of necessary evil and believed that the proper policy for the local management to adopt towards a union of its workers and towards the shop committeemen and all of the paraphernalia of organized labor was to keep labor in its place; that by no process should organized labor be given recognition or prestige, and as a consequence anything which arose to divide the men in their attitude, in their policies, in their programs, should not be discouraged by the management.

Moreover, because that particular shop was the least efficient. because the morale was lowest according to all of the tests made by the management in Baltimore, it was shut down first whenever it became necessary to effect economies, with the result that a bad situation was made worse through instability of employment—more so than on other points of the railroad.

I might incidentally observe also that by the same token the management sent the least amount of money there to effect improvements, so that the men had inadequate tools to work with. That situation is more or less characteristic and, I think you will readily agree, more or less natural when you look at it from the point of view of a management which has only so much money available with which to effect improvements.

At all events, what we did when we went out to Pittsburgh under the auspices of the unions was to tell the men what we were driving at and ask for their cooperation. Because of the fact that their union leaders told them that this was an experiment by which they had nothing to lose and certainly a lot to gain, they agreed to cooperate. With that mandate, as well as with a mandate emanating from the higher authorities of the railroad, we went into the shops, sized up the situation, and approached the representatives of the men to make suggestions as to what might be done to ameliorate the situation, to improve the tools, to do all of the different things that were necessary in order to have it appear clearly that something was going on. As an illustration, I might say that a committee of the men (which the men themselves selected) met with the management and agreed that certain tools were improper and should be replaced. In other words, the local unions were made parties to a program of improving a bad situation. They were given a constructive part to play in the process.

Another very important thing quickly revealed as a result of our survey was the necessity of giving the men confidence that the cooperative program would not in the long run work the men out of a job. What to do in that respect was the question. It so happened that the railroad company had a great many locomotives which it had been in the habit, owing to lack of facilities and because of high cost, of turning over to private concerns for rebuilding. They decided that, in the interest of making this thing go and furnishing the men a practical example of what getting together would mean, they would send some of these locomotives to Pittsburgh rather than elsewhere for rebuilding, and that was done. So we had a sort of a practical object lesson for the benefit of the rank and file.

As this process of rehabilitation went on, it was revealed that the union committeemen, whose only function inside of the plant had been to call to the attention of the management the little grievances of individuals, became a part of the plant administration; they were accepted in a sense as equivalent to the supervision. They began to discharge constructive as well as protective functions.

Dr. Leiserson referred to the necessity of bringing men and management together again through some sort of employee representation plan. How to do that on a large scale is very difficult to imagine if we simply try to conceive of it in terms of calling one another friendly names. What the Baltimore and Ohio experiment revealed was that the way to realize this hope is to bring the management together, from time to time, with the union representatives of the men, the committeemen whom the men select themselves through their voluntary agencies. These agencies, local unions, when they meet at night and at other times, determine what it is that the men think should be rectified or improved and call those things to the attention of the committeemen, and the committeemen in turn call these matters to the attention of the management.

In keeping with this theory, at all events, it developed that it was quite feasible to have the committeemen also meet the management to discuss what might be done on the part of the management to help the men, and what might be done by the men also to help the management. There are, in every in-

dustrial plant, innumerable little inefficiencies which men detect by the wholesale but which are ordinarily lost sight of, simply because the men in the ordinary scheme of things do not feel impelled to call them to the attention of the management. That was done. In addition, minutes were kept.

On the basis of this one local experiment conducted under union auspices in Pittsburgh, the cooperative proposition was next discussed in Cincinnati, when the men from the different unions on the Baltimore and Ohio met in convention. By that time it became clear what the practical objectives of a cooperative program between the men and the management might be. The attention of the men was called to the fact that stability of employment could be attained, provided the men and the management did get together. This appealed to the men from the other points of the railroad, so that they eventually passed a resolution requesting that the program be extended to all of the shops on the Baltimore and Ohio. Subsequently the system representatives of the men met with the management in Baltimore, drew up a memorandum agreement extending the program to all of the shops on the system and incorporated in the agreement several principles which are of great significance from the point of view of the technique of practical cooperation between men organized into bona-fide unions and management.

The first principle which was recognized as being desirable was that in any program of cooperation, in any program seeking to enlist the support and enthusiasm of the men in the direction of improved production, service and the like, obviously the men must share. Otherwise what incentive is there for them to participate in such a program? In addition, it was also agreed in the memorandum of understanding that a record should be kept of what the subjects were that were discussed locally; what propositions were brought to the attention of the management; how they were acted upon and disposed of. Finally, it was also agreed that periodically, about every three months, the system representatives of the men would get together and review the performance of each point, and discuss with the management programs affecting the interests of the men as a whole all over the system. This program was put into effect in March, 1924, and it has been going steadily ever since.

Simply by way of illustration of the vitality of this situation, I would like to submit these figures: that from the day of the inception of the program to date about 20,000 propositions have been called to the attention of the management by the men through their local committees, their unions and otherwise, and have been discussed with the management, and agreed to as being practical and worthy of being put into effect. They involve every conceivable detail affecting railroad operation—design, the elimination of waste, securing business, saving material, quality of work, employee training, etc. In other words, the unions, as I pointed out a while ago, play a constructive part in running the Baltimore and Ohio railroad. The men locally, through their unions, feel that they have a new part to play; their committeemen are no longer simply a sort of necessary evil around the plant; they are not regarded as more or less undesirable individuals; but they help the management; they bring to the management's attention things which otherwise would utterly escape attention.

From the Baltimore and Ohio the cooperative program has been extended to the Canadian National, by these same unions, the so-called A. F. of L. Shop Craft Unions—the machinists, the boiler-makers, electrical workers and sheet-metal workers—unions that function in the building-trades field just the same as they function in the railroad field. In addition to the Shop Craft Unions, the Brotherhood of Maintenance of Way Employees has taken up the program and is now introducing it in the Maintenance of Way Service of the Canadian National, as an example of what can be accomplished in this important department of the railroad industry.

All in all, there are to date, approximately 75,000 to 80,000 railroad workers actively engaged in a program of intensive practical cooperation with management in the railroad industry. The Railroad Employees Department of the American Federation of Labor has gotten out a pamphlet which is entitled *The Cooperative Policy of the Railway Employees Department of the American Federation of Labor*.

This particular development or policy has demonstrated the following principles as being essential to a sound program of cooperation in industry:

- (1) "Full and cordial recognition of the standard railroad

unions as the properly accredited organizations of the employees." In other words, there can be no question, or there should be no question, as to the right of the individual to join any organization he desires. Freedom of association must be conceded.

(2) "Acceptance by managements of the standard unions as helpful, necessary and constructive in the conduct of the railroad industry." In other words, after the union has once organized, it must not, if its cooperation is desired, be regarded as a sort of necessary evil. It must be looked upon as a constructive, necessary and desirable part of the industry. That must be the ideal, the responsibility that is conceded to it, if you please, by the management.

(3) "Development between unions and managements of written agreements governing wages, working conditions and the prompt and orderly adjustment of disputes." I emphasize the latter particularly because it has been found, as a result of our experience with cooperation, that we cannot permit disagreements which arise from time to time to remain unadjusted. We must devise machinery for the prompt and orderly adjustment of these differences. How to do that of course is another detail of technique which we could discuss at length.

(4) "Systematic cooperation between unions and managements for improved railroad service, increased efficiency, and the elimination of waste." In other words, a cooperative movement cannot degenerate, or must not be permitted to degenerate, into a sort of conspiracy between the workers in an industry and the management with the end in view of exploiting the public. Its objective, from the public point of view, must be improved service. Unless it works out that way eventually, it will collapse; and that it does work out that way I think will be pretty well conceded by anybody who will take the trouble to travel on any of these railroads where there is no fundamental dispute or issue between the employees and the management.

(5) "Willingness on the part of managements to help the standard unions solve some of their problems in return for the constructive help rendered by the unions in the solution of some of managements' problems." It has got to be a mutual proposition.

(6) "Stabilization of employment." The conscience of the management must be thoroughly aroused in respect, first and foremost, to its obligation to try and keep the workers steadily employed. Otherwise nobody is going to be enthusiastic long about the idea of working to improve the conduct of the industry by saving, eliminating waste, increasing production, if it is going to mean his job in the very last analysis. Fortunately, in the railroad industry there is much that can be done. In other words, railroad managements can study the problem of employment and make as much progress in the solution of that problem as in the solution of many other problems that have confronted, and do confront, railroad managements from time to time.

(7) "Measuring and sharing the gains of cooperation." It is necessary to have some idea as to what is being accomplished in order that we may know, from time to time, when to properly adjust and improve working conditions, and share the savings affected.

(8) "Provision of definite joint union-management machinery to promote and maintain cooperative effort." In order to put these principles into practice we are using the machinery that I have sketched and we are gradually developing it through a process of experimentation on the Baltimore and Ohio, Canadian National, and elsewhere. The machinery of cooperation is as essential as the desire for cooperation.

THE TRADE-UNION ATTITUDE TOWARD FACT-FINDING BODIES

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TRADE unionism is an integral part of the existing system of industry first called by its critics "capitalism". The word, once used in reproach, has in these times been adopted with pride by the advocates and defenders of the system, as was the case in regard to great religious sects and political parties which adopted as badges of honor the names first hurled at them as epithets.

Distrust and hostility toward the business system wane as it is becoming better understood how the general prosperity and individual and family welfare of modern peoples has been increased by the use of capital in production to multiply the productive power of man's labor, whether of hand or of brain. The trade union is a phenomenon of capitalism similar to the corporation. One is essentially a pooling of labor for purposes of common action in production and sales; the other is a pooling of capital for exactly the same purposes. The economic aims of both are identical — gain.

The strange survival of pre-capitalist mentality that makes so many persons subconsciously resent high wages for workingmen, or action by workingmen to better their condition, while lauding exactly similar efforts by capital to get more profits and avoid losses, is back of demands that labor act upon other motives than are expected of capital and voluntarily sacrifice its wages to increase the profits of others. It is the feudal mind speaking in a capitalist age.

In insisting on the maintenance of American wage standards in industry, trade unions are doing their part, probably more than their part, to force the corporations of the country to conduct business along scientific and efficient lines.

Nothing is more significant of the revolution in economic thinking and methods of study that has followed the swing of economic thought toward the study of the science from the

consumption standpoint, and from the accumulation of accurate statistical measurements of the national income and consumption of goods, than the changed attitude on the wage question. That the purchasing power of the American masses is the pivot upon which our whole economic system turns, and that a reduction in that purchasing power is instantly registered, not only in the distress of the masses but in the shrinkage of profits and the destruction of capital values, has become so evident in the post-war period that it is becoming quite difficult to find advocates of low-wage theories (excepting, of course, in the disorganized industry of coal) formerly so popular among financiers and industrial management.

Certainly no one will charge that a desire to promote a theoretical socialized industry is behind the thought of John J. Raskob, when he declares that "the time is coming when every workingman will have two holidays each week." Nor is Samuel Vauclain branded a socialist when he enunciates the sound doctrine that "wages must not be governed simply by the supply of labor with relation to the demand for workmen." These declarations by leaders of American business rather suggest the soundness of the doctrine of Owen Young, when he avers that "we should investigate the losers" who lack the intelligence and practicality to keep pace with American progress, but who insist on holding up the parade by continuing primitive managements.

Plainly, then, fact-finding is essential to the end that incompetents be weeded out and relegated to less dominating positions in the great scheme of American enterprise. Since labor has accepted capitalism, the big job of trade unions becomes that of forcing business men to behave like capitalists. Obviously, then, labor must be equipped at all times to prove the causes and effects of backward management, and, what is more, make its own full contribution toward the accomplishment of greater efficiency. Statistical structures behind which incompetent employers can hide, continuing obsolete methods and postponing progress, are just as harmful to the common welfare as the single-platitude office-seeker. The trade union viewpoint is that "fact-finding" should be concise, simplified, and yet demonstrate the road to achievement as completely as analysis of any given industry will permit.

In an industry insulated like coal mining, fact-finding and human liberty to pursue the facts in seeking betterments may be regarded as the first essential in promoting and permanently safeguarding industrial peace. The mere gathering and printing of voluminous information without identification, interpretation or recommendation will never solve a single problem of the industry.

The world believes, and most Americans are sure, that we in this country have accepted and adopted mechanized production methods wherever possible. Even the tabloid readers know this much. Almost everyone is also aware of the insistence of coal operators on reducing mine wages in the union coal fields. Indiana and Illinois are the two largest union coal-producing states. Labor costs in mechanized producing mines in these states range from \$1.00 to \$1.25 the ton. Reliable engineers insist that the great majority of the remaining hand-loading mines can be so transformed by mechanized operation as to pay all interest charges on the investment, taxes, depreciation and depletion, and yet load coal into the railroad cars for \$1.15 the ton, based upon present wage rates of \$6.00 to \$10.00 the day. Yet the operators in Indiana and Illinois insist on reducing wages to meet the competition of Western Kentucky on a mine run basis of \$1.35 f.o.b. mines, with an existing freight rate differential in favor of Indiana and Illinois of thirty cents the ton. This demand represents the sort of laggardness on the part of mine management to which the leadership of the Miners' Union replies that the American coal miner will "take no backward step."

The crying need of the coal industry is leadership that will gear itself to American thought and embrace a practical scientific program—leadership that will face the facts, undertake progressive betterments and put to rout the section-hand mentality which has shackled coal production and distribution to the antiquated methods of daddyism. Fact-finding without some force to revamp the industry on constructive lines will avail nothing.

Such, at least, has been the experience of the United Mine Workers of America, which, as the party of the second part to the production of coal in these United States, has probably experienced more fact-finding bodies than any other trade

union. Within eight years two Government Coal Commissions have investigated bituminous coal and pronounced it a badly functioning and disorganized industry. Using the basic facts reported by these Commissions and supplemented by direct inquiry, the Institute of Economics, the Russell Sage Foundation and numerous other agencies have publicly declared the bituminous coal industry overdeveloped, mismanaged and tragically uneconomic in its operation. Long before these official bodies and independent agencies penetrated bituminous coal, the United Mine Workers of America knew as much.

Prior to the advent of the War, the United Mine Workers of America solicited the Government, on various occasions, to investigate the lack of organization and resulting deplorable economic conditions within the coal industry. The union has always believed that, once the American people fully comprehended the uneconomic evils within the coal industry, public opinion would force a correlation of effort between the various coal-producing states and the Federal Government that would put the vital, basic industry of coal on a parity with the railroads and public utilities. Union leaders think that the public interest demands such a relationship, since coal constitutes the chief factor outside of labor costs in our transportation systems. Another factor is that of the conservation of human life. Under federal regulation it would be possible to standardize safety measures and require certificates of competency for employment within the mines. And still of vital public importance is the matter of conserving high-grade coal deposits for the uses to which they are specifically adapted and, as a further protection, imposing mining conditions which will insure the greatest percentage of recovery. This program of intelligent conduct of the coal industry advocated by the United Mine Workers is, of course, predicated upon the miner's finding his just economic level in the relationship of American enterprise and progressively advancing along with the rest of American civilization to higher standards in both workshop and home.

During the past ten years consumption of bituminous coal has remained stationary, averaging 486,000,000 tons per year. The standstill of coal despite the great progress of all other

American industries has resulted from the development of greater fuel efficiency by the railroads and commercial users. methods which are coming into common usage. Looking twenty-five years in advance, one sees little hope that bituminous consumption will increase. As an example, in 1920 the railroads used 170 pounds of coal to move 1,000 tons of freight a car-mile; in 1925 the average was 140 pounds. The Delaware and Hudson has recently installed two railroad locomotives for which it is claimed that only 55 pounds of coal are required to move 1,000 tons of freight a car-mile. Only half the coal was required in 1927 to produce a kilowatt-hour as compared with 1919. Thus it is plainly evident that in the case of the coal, unlike other commodities, consumption cannot be increased through high-powered educational advertising campaigns. Coal as a selling proposition is the one commodity the "go-getter" does not include in his bag of merchandising tricks.

The present status of bituminous coal is that of bankrupt companies and impoverished workmen. Six thousand coal companies are engaged in a ruthless competitive warfare, selling capital assets and labor on the auction block to four thousand and five hundred organized purchasing agents.

Hoping to avert what is now taking place, government agencies sponsored a long-time wage agreement, and, at the government's solicitation, the miners and operators negotiated a three-year wage pact, April 1st, 1924, in Jacksonville, Florida, which simply continued in effect the wage rates and working conditions which were handed down in the award of the Bituminous Coal Commission, appointed by President Wilson in 1920.

The following table gives a clear statistical picture of the over-development in bituminous coal mining in seven states. The seven states listed below produced 84.4 per cent of the total production of 483,687,000 tons in all states during 1924. Some 1250 mines, representing 22.0 per cent of the 5,693 reporting mines in the seven states, produced 76 per cent of the production of these states and 64 per cent of the production of mines in all states. The total number of bituminous mines reporting to the U. S. Geological Survey in 1924, for all states, was 7,586.

BITUMINOUS COAL PRODUCTION, 1924

State	Number of Mines Producing 100,000 Tons	Total Tonnage Mines Producing 100,000 Tons	Per cent of Total Tonnage of State	Total Production for Entire State
Illinois	165	61,294,279	89.8	68,323,281
Indiana	70	16,889,145	78.6	21,480,213
Ohio	99	20,975,628	68.8	30,473,007
Pennsylvania	377	97,890,294	75.	130,633,773
Kentucky (East)....	130	25,215,778	55.9	45,147,204
Kentucky (West) ...	33	5,431,938	12.	10,693,464
Virginia	28	8,269,241	77.4	101,662,897
West Virginia	348	73,531,402	72.3	
Totals	1250	309,497,705		408,413,839

The most untrained, unimaginative and unconcerned of our business men can readily discern from this statistical picture that unrestrained competition means destruction of the capital assets of the coal companies, as well as the degradation and enslaving of the coal miners.

West Virginia operators for the most part, and Kentucky operators as a whole, refused to yield to the government's solicitation; they were unwilling to be bound by a wage scale that would stabilize the cost of production, eliminate high-cost uneconomic mines, and retain for American coal miners American wage standards. Coal miners were brow-beaten and intimidated by means of injunctions and by eviction from their company-owned homes. Eventually the miners were forced to accept wage reductions in West Virginia and Kentucky. As forecasted by the union leaders, wage-slashing is bottomless when competition rests in the hands of men determined to continue operation regardless of the levels to which wages are forced to drop. From \$7.50 a day, wages in West Virginia and Kentucky have been reduced to as low as \$2.00, with less than half-time employment, while the work day has increased in many instances from eight to ten hours.

The effect of coolie-izing American labor in Kentucky, West Virginia and Virginia has been to increase the tonnage sold below and around production cost to displace northern field coal. This policy has spread bankruptcy to all lines of busi-

ness in the mining regions of these states. Here is the story of coal produced and sales realizations:

In 1923 Kentucky produced 44,777,000 tons of coal, for which Kentucky operators received \$113,735,000. In 1926 Kentucky produced 66,330,000 tons of coal, for which Kentucky operators received \$110,194,000. Production was increased 21,553,000 tons, or 48 per cent, while sales realization decreased \$3,541,000, or 3 per cent.

Virginia in 1923, produced 11,761,000 tons of coal, for which Virginia operators received \$32,460,000. In 1926 Virginia produced 14,493,000 tons of coal, for which Virginia operators received \$24,827,000. Production increased 2,731,000 tons, or 23 per cent, while sales realization decreased \$7,633,000, or 24 per cent.

In 1923 West Virginia produced 107,899,000 tons of coal, for which West Virginia operators received \$285,934,000. In 1926 West Virginia produced 147,209,000 tons of coal, for which West Virginia operators received \$270,864,000. Production increased 39,310,000 tons, or 36 per cent, while sales realization decreased \$15,070,000, or 5 per cent.

The effort of West Virginia, Kentucky and Virginia operators to extend sales, on the basis of price only, in the competitive markets geographically linked to the northern coal fields, resulted in wholesale repudiations of large wage contracts by what had been regarded as strong and reputable coal companies. Thus external competition added to the internal competition within the northern coal states is responsible for the present-day demands of union operators for wholesale wage reductions in the long-established union areas.

In fighting these demands for a wage reduction, the Mine Workers' Union is endeavoring to prove that unjustified wage slashing, a sort of deflation that deflates nothing but wages, is not the panacea to correct the ills of the bituminous coal industry. Fighting with all their economic force to preserve American wages for the men who mine the coal, the United Mine Workers have carried the cause of the American coal miners to the United States Senate for investigation. The Interstate Commerce Committee of the Senate is now holding sessions developing the facts of ruthless competition, with the hope that some form of legislation may be enacted to stabilize

the industry. In the bill of complaint upon which this senatorial action was brought about, the Mine Workers charge certain railroads with being parties to a conspiracy to deunionize the coal mines for a twofold purpose: (1) to secure cheaper railway fuel; (2) to reduce the mine workers' wage so that it could not be used as a yardstick measurement by which maintenance men and other railway employees can make comparison in seeking wage advances. Testimony before the Senate Committee has already sustained the Mine Workers' charge against the railroads. Evidence supplied in the testimony of coal operators reveals that northern railroads have transferred large tonnage requirements to southern coal fields where wages have been depressed, despite the fact that increased freight costs in some instances do not reduce the delivered price of the coal.

The transfer of railway fuel was an invitation to the northern field operators to depress prices below production costs. Lacking leadership, and with no organization to fight back, northern field operators responded to the railroads' invitation by reducing coal prices, regardless of production costs. The disastrous results of such competition may be illustrated by the following table of coal prices received from the railroads by the Pittsburgh Coal Company, which company assumed the lead in repudiating its labor contract. These figures were submitted by W. G. Warden, Chairman of the Board.

COAL PRICES RECEIVED BY PITTSBURGH COAL COMPANY

Year	From B. & O. RR.	From Erie RR.	From N. Y. C. RR.	From P. & L. E. RR.	From Penn. RR.	From Montour RR.
1923.....	\$2.96	\$2.64	\$2.82	\$2.81	\$2.73	\$2.83
1924.....	2.58	2.48	2.35	2.34	2.64	2.56
1925.....	2.38	2.35	2.22	2.13	2.00	2.51
1926.....	2.75	2.26	2.15	2.06	1.88	2.38
1927.....	2.20	2.10	2.13	2.02	1.90	2.29
Decrease in cents per ton from 1923 to 1927...	.76	.54	.69	.79	.83	.54

The present railroad freight rates were predicated on coal prices ranging from \$2.25 to \$2.50 the ton. The attempt of the Pittsburgh Coal Company to deunionize its mines and reduce coal production costs and sales prices has cost that company approximately \$12,000,000 in actual losses in less than three years.

The story of railroad success at the expense of coal company capital, mine workers' wages and commercial consumers can be found in figures submitted by the Pennsylvania Coal and Coke Corporation, which show that for the years 1923 to 1927 inclusive the railroads bought coal from 13 to 51 cents the ton cheaper than the commercial users:

PRICES RECEIVED BY PENNSYLVANIA COAL AND COKE CORPORATION

Year	Pennsylvania Railroad	New York Central Railroad	Average Realization All Coal Sold
1923	\$2.85	\$2.72	\$3.36
1924	2.19	2.25	2.48
1925	1.85	2.03	2.24
1926	2.01	2.06	2.30
1927	2.14	2.06	2.27
Decrease in cents per ton between 1923 and 1927 .....	.71	.66	

To show more clearly the success of the railroads in obtaining cheaper coal, the following table, taken from the reports of the Interstate Commerce Commission, detailing comparative coal costs for thirteen Class 1 railroads for the year 1923 and the month of December, 1927, will show to what extent the railroads, consuming twenty-seven per cent of the total bituminous coal production, are profiting at the expense of the disorganized bituminous coal industry, while the domestic consumer reaps no benefit whatever.

The success of southern operators in breaking down union standards was accomplished through the medium of federal and state injunctions. In West Virginia 316 coal companies, through a single non-resident corporation, have obtained a

COST OF COAL TO RAILROADS

Railroad	Year 1923	December, 1927	Decrease in cost per ton, since 1923
Pennsylvania	\$2.77	\$1.87	\$0.90
New York Central	3.44	2.60	.84
Boston & Albany	5.73	4.42	1.31
Baltimore & Ohio	2.65	1.65	1.00
Pittsburgh & Lake Erie	2.83	1.94	.89
Wheeling & Lake Erie	2.82	1.74	1.08
Illinois Central	3.03	2.24	.79
Louisville & Nashville	2.63	1.86	.77
Virginian Railway Co.	3.00	1.96	1.04
Chesapeake & Ohio	3.13	1.58	1.55
Norfolk & Western	2.69	1.64	1.05
Père Marquette	4.02	3.38	.64
Lehigh Valley	4.64	3.47	1.17

federal injunction that enjoins in perpetuity the United Mine Workers from any activity whatsoever in West Virginia. This decree is based upon the asserted property right of these companies, acquired by yellow-dog contracts, to preserve the non-union status of their workmen.

In Western Pennsylvania, a resident corporation, the Pittsburgh Terminal Coal Company, succeeded in securing a similar injunction, the court holding that the intent to persuade men to cease employment was an interference with interstate commerce.

By resort to injunctions the coal operators have established a judge-made law that the coal business is interstate commerce and the United Mine Workers are now forced to accept this interpretation. In consequence therefore, the United Mine Workers insist that the entire structure of the coal industry be dealt with as a matter of interstate commerce and are now urging the Congress of the United States to legislate to this effect.

1. We ask Congress to prohibit the abuses that have sprung up in the issuance of federal injunctions in labor disputes.

2. We ask that the Interstate Commerce Act be so amended as to prevent the railroads from exploiting the coal industry.

3. We ask for legislation that will enable consolidations in line with the recommendations of the U. S. Coal Commission.

4. We ask for the creation of a Federal Coal Commission

to regulate the industry, with power to license coal-mining operations, to determine and to recommend to the Interstate Commerce Commission scientific freight-rate adjustments, to establish mediation and conciliatory courts, and to protect the public against unfair prices.

The leaders of the miners' union hold that the public welfare demands governmental regulation. The fact that existing laws do not grant authority for governmental regulation is no indicator as to the practicality or desirability of government control. Laws can be passed that will enable sane regulation, eliminate uneconomic mines, restore normal and healthy competitive relations, establish American standards of employment and give to the public fair-priced coal. Primitive management must give way to intelligent direction. Direct examination of the industry has enabled the United Mine Workers to present the case of bituminous coal to the United States Senate. Despite the baseless demand for "less government in business", the union is seeking stabilization through governmental supervision, and this action is positive proof of the value that the United Mine Workers place upon the much neglected and widely misunderstood function of fact-finding.

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EMPLOYEE REPRESENTATION PLANS AND LABOR ORGANIZATIONS

DISCUSSION

PROFESSOR HERMAN OLIPHANT (Professor of Law, Columbia University; Assistant Director of Industrial Relations Division of Emergency Fleet Corporation, 1918-19; Associate Counsel for Unions in Interborough Injunction Litigation) : One having listened to the first three of the papers dealing with the subject of company unions¹ cannot approach commenting on it without a chastened spirit, in view of the richness of the material which those papers lay before you for consideration.

What does this company union movement mean? One who has worked with and observed labor relations for some time cannot help at times having the feeling, or at least the query, as to whether we may not after all be merely paddling about in large circles. We find, for instance, that the labor movement in this country is today desperately attempting to retain a position which some of us in our thinking some time ago took as a point of departure. Not a few of us, no doubt, have had the feeling for a long time that lying at the very beginnings of any sound and wise solution of our major problems in industrial relations was a set-up which would enable us to deal with labor in groups that extended beyond the individual plant. And yet within a period of a little more than a half-dozen years the company union movement sweeps over the country and we are compelled to pause and seriously to ask ourselves the question: First, in predicting the form which the administration of labor relations is eventually going to take in this country, do we face a choice between organizations of men confined to a single plant or company and inter-company unions? Or does it all mean that the company union movement springs up in response to a need not otherwise being met, and that after all, the company union movement and the inter-company union movement are things which can dwell together in the same house in peace?

¹For papers by Professor Leiserson, Mr. Ellerd and Mr. Beyer, *cf. supra*, pp. 96, 110, 120.

These questions cut to the root of the problems with which most of us have been wrestling. I am pretty sure that we could all agree on this at least: Only an excess of confidence would cause any of us to say that we now know the answers to these questions. We could probably also agree on this: A potent ally in arriving at an answer is going to be time fraught with experience. Therefore one of the things which the situation requires, in this rivalry between the two forms of labor organization, is a free field for both with no favors for either.

Now, this remark brings me to the excuse if not the justification for a student of law being on the program. The only important legal aspect of the general question of company unions and union-management cooperation is the relation of the anti-union promise, sometimes more dramatically called the "yellow-dog contract," to the whole situation. What about the company union when it is accompanied by an individual promise executed by each workman, obligating him not to join any other form of labor organization?

If the company union which such a promise accompanies (bearing in mind the practical effect of judicial approval and enforcement of such promises or protection of such promises against labor organizers by means of the injunction) is not the result of a bona-fide effort to permit men in the plant to organize in an independent body capable of expressing their opinions and wills, the case against the validity of the anti-union promise, it seems to me, is pretty clear for this reason: so long as the anti-union promise is printed on a piece of paper with the dotted line at the end, and is handed out for the individual workman to sign, he not being fortified in his decision to sign or not to sign by the adjacent strength of his fellow workmen, the net result is a wholly bullet-proof device fatal to all unionization.

A more serious question and one about which we know little, if anything—I have time merely to raise it with you and consign it to your meditation—is this: Supposing that the company union which the "yellow-dog" promise accompanies is an honest effort on the part of management to create an organization independent of management domination, do you have in that situation such a disparity of bargaining power between the employer on the one hand and the group

of workmen limited to his plant, on the other, that the "yellow-dog" promise should not be protected for the purpose that I originally described? In other words, if the promise is protected, can we maintain, during a period of experimentation with these two competing forms of labor organizations, a free field with no favors?

MR. HENRY S. DENNISON (President, Dennison Manufacturing Company, Framingham, Mass.): I will accept very gladly all of the warnings to employers that Dr. Leiserson gives. Like the Armour Company, when we started consideration of employee representation we faced the risks and the possibilities, and in so far as we could, accepted the responsibilities. We had no notion that a movement of this sort, especially under the conditions of the time, could be confined to some comfortable boundaries that should leave us as employers freer than ever to do as we pleased. Once started, the movement might take forms no one could foresee.

I want to echo Dr. Leiserson's criticism of the widespread platitude that this was a scheme to bring about closer personal relations. The people who said that proved that they knew nothing of the inside of factories and workshops. The employee representation plan introduced, rather, extra machinery to make the whole personal relationship even less close than it was, and yet it had other values so important that it was a great shame to blind it by any such misunderstanding.

I want to take issue only with what seems to be a point of view of Dr. Leiserson's. He seems to see employee representation and trade unionism as too much alike, and therefore too much in competition with each other. For example, he limits his survey, his definition of employee representation plans, to those which do not acknowledge the trade union as a legitimate device for representation.

In our own plan, and I think in most that have survived and been at all active, there is specific acknowledgment, to begin with, that trade-union representation is an admissible plan; that if through any conjunction of circumstances employees prefer that sort of representation, it is equally open. The "yellow-dog contract" is, thank God, as yet exceptional. Most of the plans with which I am at all acquainted make an ab-

solutely open place for unions, and many, like our own, have both union and employee representation running along together, each serving their particular functions. Although it is quite impossible in our case, the union representation being so small in a specialized industry like ours, to make a combination of the two, as the Baltimore and Ohio has done, we have still in effect active opportunity for the two, either and both being used as occasion demands.

The foregoing criticism also would cover the point which Dr. Leiserson made and which Mr. Beyer has already answered, that trade-union leaders were asleep when they allowed company unions to be formed. In special cases they undoubtedly were, but as a matter of fact, it insistently seems to me that there are functions that belong to each kind of union. There are places which each can fill. Within any given company there are likely to be places which both can fill, as we found within our own experience.

As I tried to state in a rough way at President Wilson's first industrial conference—which was materially helped in its breakdown by just this misunderstanding of the whole situation—a national association should have the strength to perform a defensive function in preventing aggressive action against the interests of labor on the part of employers; whereas constructive possibilities lay rather in the highly decentralized but defensively much weaker company union or shop committee plan. There is the general line of distinction of function which I suspect will be greatly refined by experience, particularly by such experiences as those of the Baltimore and Ohio, where the difference of function between the union and the shop councils must sooner or later work itself out in rather precise fashion.

It is significant, too, that in this country and in England as well these different forms have developed. They are two quite different countries and have quite different union conditions, and yet there are the shop councils at work on shop problems in England.

There has been nothing said about one field of development which is nevertheless proving in our own experience to be of very great importance. That is the development of the representative back on his working floor and at his job. Wholly

unexpectedly to us, this development has proven to be one of the most valuable results of an employee representative system. We never thought of the representative's personal function, for the first two or three years, but little by little he is cooperating with the foreman on the floor, accomplishing results which no appointee of the company or anybody else could accomplish, acting as a sort of highly functionalized or specialized assistant foreman. As a matter of fact he is filling a place that those of us who have tried to find the basic facts that underlie our organization forms have been interested in for years. We have tried to discover whether there is not some part of a foreman's job that could be better done by an elected man than by a selected man. Obviously, all the technical parts of a foreman's job can be better done by a selected man. We ourselves had set all that possibility aside because we made an analysis and learned that we could not find the separate parts of the job. Then along came the elected man, who has found a variety of different ways of cooperating with and working in partnership with the foreman and has given us results in the fields of management and discipline that were very much higher than we have ever known before.

Dr. Leiserson's allusion to employee representation as a form of democratic control of industry deserves to be analyzed. What do we actually mean by that word "control"? What are the possibilities of control? The world has tried it out a great deal on the employers' side and obviously we are not wholly satisfied or there would not have developed any unions or company unions or representation plans. Control by the employer has left much to be desired. Control by employees frankly considered has offered no more hopeful prospect. Control by balance of power was the old escape. We always thought of capital and labor as being, somehow or other, in a miraculous balance. Well, a balance never controlled much of anything. The balance is a net result and sometimes, as we have discovered since 1914, a most unfortunate net result. No student of organization can now very heavily rely upon a balance of power. Nor can we, at the moment, feel much greater hope in thinking of control as lying in all the people as they organize themselves into a nation or a government. That again, at least at the present stage of our ability to manage, is outside the range of immediate possibility.

Then how, where, can this thing we call control lie? Frequently we talk about public opinion, but some brilliant chap like Lippmann analyzes public opinion as a vague sort of thing, easily manipulated, raw, crude, hardly a control at all. Isn't it more likely that control will grow up through development of a Common Law? Professor Leiserson has himself, I think, frequently suggested the slow progressive development of a Common Law which becomes unconsciously accepted as a sort of professional standard of behavior, until it becomes almost unbreakable—the slow development of a set of acceptances by groups of humans respecting situations in which the facts are known.

If we can do away more and more with the secret diplomacies of business, with the concealment of facts, with the distortion of facts, we can trust, with Mr. Oliphant, to the future to develop something of a law of the situation, something of a common acceptance that this or that is right to do, and only this or that can be done.

Now, in that development, if it is anywhere near true, we must look with favor upon employee representation, more active and closer constructive relationships between unions and employers, and any other form of activity which tends to bring more and more of the intimate facts out to have a part in the consideration of final actions and policies. So long as we double and treble and quadruple the cases where annual surveys of market conditions are made by employers themselves, as with Mr. Oliphant, instead of leaving them helpless to the buncombe some of my fellow monarchs have passed out to them in the past, there is possibility for the growth of this law of the situation, a standard of professional ethics and practice which I think is all we can look to, at the moment, to give us the ultimate form of control.

I don't see how we can as yet get sharp ideas on the subject, but we must, nevertheless, before we can form our types of organization on the basis of knowledge of the forces that are at work, know something of what we mean by that word which we bandy about so freely, but about which I think we know less than almost any other in the industrial dictionary—control.

MR. ELLERD: I seem to sense in Mr. Oliphant's discussion a belief that some relation exists between our plan and the promise not to belong to a union. If that belief existed in his mind I want to correct it, because our plan specifically points out that membership in a union has no effect on any man's activity.

PROFESSOR OLIPHANT: I regret if I gave that impression, because I understood that that was not in the plan.

MR. STUART CHASE (of the Labor Bureau, Inc., New York City): I want to speak briefly of one or two attempts that have been made by the organization with which I am connected to promote a better basis for the cooperative plans between worker and manager.

The remarks of Mr. Dennison in respect to secret diplomacy are particularly apropos here. I would like to stress the importance of the unions' knowing the true financial condition of the employer as a basis for working out a real cooperative agreement.

The worker too often believes in a myth of fabulous profits. He is in a fair way, accordingly, by pressing his demands too far, to ruin his employer's business and to do himself out of a job. That has happened in the past. On the other hand, if he does not know his employer's financial condition and earning power, he may be led astray by his employer's protestations of poverty unsupported by facts and refrain from making a strong attempt to get a more equitable division of what may be an unreasonably high rate of profit.

In the organization with which I have been connected, we have made a number of financial surveys of employers' profit-and-loss accounts, balance sheets and general financial conditions. We have worked out a definite technique that is a valuable thing for labor organizations and I think also for management. For instance, in the New York printing trades, I made a joint survey with an accountant who represented the employers. We went over the books of some five hundred printing shops throughout the city and reported accurate and truthful results covering a period of years as a basis for wage negotiation. My brother accountant and myself made one

joint report as to the facts and then we made our separate interpretations of the facts.

Again in the case of the Naumkeag Steam Cotton Company in Salem, Mass., while the books were not thrown open to us, through our own sources of information we were able to make a very complete analysis of the financial affairs of the company, its astonishing growth, its rate of earnings, the condition of its markets and so forth. This analysis was presented to the union and was used by it in a series of negotiations which have had an encouraging outcome as the facts now stand. How the Naumkeag employees and the company are getting on at the present time may be indicated by the following clipping (March 1928) from the *Trades Union News*:

The union realizing that in order to work steadily and maintain the high standards they are enjoying agrees to promote the distribution and sale of the product of this mill in every legitimate way possible. The efforts put forth in this endeavor have been in a large measure responsible for the Naumkeag mills ability to work steadily night and day producing a volume of yardage far ahead of its competitors. The union pledges itself to carry out economies in the manufacturing end, and is always willing to adapt itself to the introduction of new and modern machinery. While it is true that many of the workers do not realize the import and are suspicious of this part of the agreement, the more intelligent among the membership see the many advantages being gained by all. In due time every one will agree that labor too must become as important a part of industry as machinery, building, money, management and all that enters into industry, and that in order to continue to enjoy the present prosperity it must search to find where economies can be effected, which management may be unable to see.

This may be a little optimistic, but it reflects a reasonably happy arrangement between a union of three thousand men and a very prosperous and stable corporation.

Finally, we have been called upon in cases of organization, such as the recent attempt of the Pullman porters to organize. In this case, without any cooperation at all from the employer, we made for the benefit of the union a careful summary of the corporation's accounts. I analyzed the Pullman's records back to the very beginning, and made it very evident that the company is in a strong enough financial position to pay Pullman porters a reasonable wage scale.

Of course this sort of thing is absolutely worthless if it is

inaccurate, biased or prejudiced. But if a cold statement of the facts can be presented to the union, the men know, as the Amalgamated Clothing Workers know, when is the time to press their employers for better wages and when is the time to go lightly in order to maintain the industry in a moderately healthy condition.

MR. WARREN S. BLAUVELT (Hudson Valley Coke and Coal Products Corp., Troy, New York): I have been very greatly interested in the development of the Works Committee plan and have used that plan myself for some eight or ten years. There was one thing that was not brought out by Dr. Leiserson or anyone else, which seems to me to be of very great importance, namely, that through the Shop Committee it is possible to get to the entire organization something of the dramatic value of the work that is going on. I have found that of tremendous utility not only in industries but also in the coal mines. When men and managers recognize the fact that they are not merely earning a day's pay but that they are also engaging in an important part of the work of the world, it is a good deal easier to avoid unnecessary friction. The Pit Committees that were organized by the Fuel Administration during the war accomplished equally good results in the union and in the non-union fields when they made men feel that they were winning the war, that they were saving the lives of their "buddies" and making it possible for the latter to come home more quickly. The results could never have been achieved if it had not been for the Pit Committees that got that idea across.

I have been very much interested in fact-finding, but in my opinion it does not go far enough. It is like hiring more doctors and nurses when there is an epidemic of Asiatic cholera, but paying no attention to the pollution of the water. In the coal business, as an Indiana operator, I thought that the biggest monkey-wrench in the machinery was not the Jacksonville Agreement but rather the fact that in the readjustment of freight rates after the war our rate to the great Chicago market on the weighted average was advanced, I think, 113 per cent, while from the non-union fields in the Crescents it was only advanced 60 per cent. I will say, however, that before the changes in rates the United Mine Workers had tried

to take away from the operators practically all of the geographical advantage, and they nearly succeeded. Then the railways took away more than there was left and the industry was put in a pretty bad shape.

Hence one of the very first matters for consideration is the question: Is there no such thing as an equitable system of freight rates? One section of the country can be ruined and another section of the country can be advanced by the absolute lack of any general principles to govern freight rates. In my opinion, the establishment of the principle that freight rates should vary in proportion to the cost of the kind of service rendered, and that no changes in freight rates or freight-rate relationships should be made except on this basis, might in the course of perhaps fifty years do something toward the stabilization of the coal industry.

Another point is that there has been almost no investigation to discover the ultimate results of the incidence of taxation. Taxation is of vastly more importance to industry than people generally think.

A third matter that needs to be investigated, if we are going to remedy industrial situations, is the question of the effects upon industry of the unnecessary risks arising from the lack of any real standard of values. I do not know whether Professor Fisher's method is exactly right, but his principle is basically sound. In almost every business undertaking that extends over five years, the hazards are profoundly increased because an obligation in dollars does not mean the same thing five years hence as it does today and may mean something still different ten years hence. Nobody knows what those risks are. Industry as a whole suffers unnecessary hazards because the dollar is not a standard of values.

PART IV
PRESENT NEEDS IN INDUSTRY

THE ROLE OF INSURANCE IN PROMOTING THE COMMON INTERESTS OF CAPITAL AND LABOR¹

HALEY FISKE

President, The Metropolitan Life Insurance Company

THE problem of industrial relations is now very much before the public eye. The history of labor and capital for the last one hundred and fifty years reveals incessant conflicts between workingmen and their employers, accompanied by terrible incidents in the way of strikes and riots and incendiarism and even murder. But there has been a great change in the last few years; both a change in the attitude of capital or employers, and then a corresponding change in the attitude of labor.

In addition to the interest which every citizen has in this subject, I have by reason of my position as President of the Metropolitan Life Insurance Company a very particular interest. That is because of the nature of our business. We have some forty million policies in force on about twenty-five millions of policyholders. These policyholders include men, women and children who live almost altogether in the cities and towns of the United States and Canada. As you see, we have close to one out of every five in the populations of these two countries insured with us. But in view of the fact that our people live in the cities, the comparison is better made with urban dwellers. We estimate that at the present time there are some sixty-seven million inhabitants in urban United States and Canada. We do better, therefore, than one out of every three in the urban population. As a matter of fact, we are even more closely associated with the public, for our business is largely a family insurance business. We estimate that we have insured with us 53 per cent of all of the wage-earners' families in the urban population available to us in our Industrial Department alone, and if we should include our

¹ Introductory Address by Mr. Fiske as Presiding Officer at the Third Session (Dinner Meeting) of the Semi-Annual Meeting of the Academy of Political Science, April 11, 1928.

ordinary and group business, we certainly have representation in 60 per cent of the homes of the two countries. The Metropolitan is, as you know, a mutual company. It is owned by its policyholders and in view of the fact that we include so large a part of the people of the country, our company is second only to the government itself in touching intimately the life of the people.

One of the first lessons we try to teach these policyholders is that they are capitalists. With about \$2,500,000,000 in assets, the company is the largest financial institution in the world, and the problem is how to get home to the holders of its policies, even to these working people, that they have a share in these capital assets; that they are indeed capitalists having a direct interest in the welfare of the community as represented by the investment of capital—over \$1,000,000,000 in mortgages, nearly \$1,000,000,000 in securities of railroads and public utilities. For years we have been preaching that doctrine and teaching our agents, of whom we have twenty-odd thousand throughout the country, just that lesson. I think that it is important to bring to the minds of the workmen that they as well as their employers are the owners of capital; in other words, that there is a common interest in investments, a common interest in manufacturing, a common interest in the running of railroads, in the carrying on of public utilities; and that it is their interest as well as the interest of the owners of the capital stock and of the bondholders to make these companies prosperous.

Moreover, we have been engaged for twenty-six or twenty-seven years in an effort to improve the health of these working people, to make them better citizens in the capacity to work. We have had some very amazing results. In 1911 the mortality of these industrial workers, the owners of our policies, was twenty-four per cent higher than the mortality of the general population. Our health work has brought the mortality down, in 1925 or 1926, to 1.3 per cent less than that of the general population; and when you consider that the general population includes the well-to-do and the farmers and the people who do not perform daily toil, it seems to me and it seems to everybody a very extraordinary result that we should show a better mortality among these laboring people

than among the population as a whole. The Health Campaign has been carried on in two ways. First, every industrial policyholder has the right, when ill, to the services of a trained nurse. More than thirty million visits have been paid by the nurses to the homes. In addition, in the way of instruction and education, we issue health literature. Nearly 500,000,000 pamphlets and leaflets and books have been distributed during this period. That is what you may call a direct contact with the working people, the wage-earners.

We have an indirect method of contact, which is perhaps even more interesting. The Group Division in our office issues group policies. A group policy is a policy taken out by the employer for all his employees, without regard to health, and without medical examination. Such insurance is contributory, that is to say, the working people, the employees, are paying a part of the premiums which insure their employers, and correlatively the insurance on themselves is partly paid by the premiums collected from their employers. In other words, we have brought together employer and employees in a project for the benefit of all of them, providing a common interest in the occupations in which they are engaged.

These policyholders—and there are 1,250,000 of them in this Group Division—hold insurance to the amount of \$1,800,000,000. The wage-earners in the industrial departments have the benefit of the visits of nurses and the distribution of literature; but even more important, as it seems to me, is a bureau in the Group Division called the Policyholders' Service Bureau, through which we indirectly reach the wage-earners.

In other words, we are engaged in a process of education of employers in the welfare of their employees. It takes many forms. The forms of insurance alone are a very important factor, because they include insurance against death, sickness, accident, total disability, accidental death and dismemberment. In other words, the hazards of employment are carried by insurance. That of itself is a very important thing in bringing together the employers and the employees in a common interest in the work in which they are all engaged.

But we go farther than that. We are endeavoring to instruct the employers as to how they can best treat their employees. There are various subdivisions of this bureau.

There is an important one on personnel; I hardly need to explain that. There is a subdivision on safety engineering, which defines itself; one on the occupational hazards of industry, such as dust, fumes, chemicals; one on housing. We give instruction, when it is asked, on the treatment of employees which we think would be efficacious for employers to adopt: it covers cafeterias and recreation, fresh air, good lighting, washing facilities, and other factors which produce healthful conditions in working places. Then there is a very important bureau which looks after pensions. The notion is becoming quite prevalent now that there should be in these groups a pension system to which would be contributed the deposits by employer and employee, so that you may take any age you like or any amount you like, or any multiplication of the wages or fraction of the wages you like (no two pension contracts are alike), fitting them to the particular industry in question.

Think for a moment of the spectres which haunt workingmen—death, sickness, accident, dismemberment, disability, dependent old age! These are the things that we are attacking through this Group Division. We are trying to drive away those spectres and make the workingmen contented and happy. Better than all, we are trying to relieve their fear of the future, a very real fear! Through pensions, of course, a workingman's anxiety as to what will become of the family when he becomes disabled or old, entirely disappears.

The things that I have been enumerating are the constant things that worry men and make them discontented and unhappy. If we can get the employer and the workingmen together in a united, joint interest toward making the men contented and happy and fearless of the future, we have done a great deal to solve the various problems that arise in industrial relations.

There is another spectre called unemployment. We have thus far been unable to engage in unemployment insurance because the statutes of New York do not permit it. We have been agitating that subject for years. We are ready with the data on unemployment insurance through groups. Only within a day or two, I have seen some movement toward the removal of obstacles to the amendment of the law. Curiously

enough, the principal obstacle has been the attitude of the trade unions. Just why, I have asked, and they have not answered; but it has been put to them in such a way that I think I can see hope of convincing them that it would be a good thing to do.

The evolution of life insurance has brought about a change in the attitude of workingmen toward insurance generally. There was a time, years ago, when trade unions were opposed to industrial insurance and fought against group insurance on the theory that the whole problem was a matter of wages; that if men get wages which are adequate, they can support themselves and provide against the eventualities of life which worry them, and lay up money for the future.

An extraordinary sign of a change of attitude came when labor itself appealed to the legislature for permission to insure members of trade unions by group insurance. Group insurance, as I have told you, is the insurance by an employer of his employees, and they must be in the one place of business, in the one occupation. Trade-union members of course are employed in various occupations, under various employers, but united in the kind of work they do.

Out of that step grew another extraordinary advance in the formation by the unions of a life-insurance company which undertakes to insure workingmen. Some time ago I heard they had some \$70,000,000 of insurance after only a year or two of operation, but most of that was group insurance. In other words, the trade unions themselves have seen the advantage of this joint contribution between employer and employee in the welfare of the working people.

There have been many other incidents which you probably have read about from day to day, indicating a real advance on the part of labor toward a better understanding of the problems which confront employers; and I have told you some of the things which indicate a better understanding by employers of their great responsibility for the welfare and the future of the human beings whom they employ. And so we feel that the picture of the future is very likely to be a very beautiful one. We can see the day—which we hope will come—when there will be that harmony in industrial relations which such discussions as this do so much to bring about.

A CONSTRUCTIVE ANTI-TRUST LAW

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I HAVE one point, and one point only, that I desire to make in this discussion. The one point I wish to drive home is that the United States Government at the present time should enact an affirmative anti-trust law; to use a well-worn, well-nigh worn out word, it should enact a constructive Sherman Law, if you please.

The rule of the Sherman Law as interpreted at the present time, that unreasonable restraints of trade by agreement are unlawful, is traditional among English-speaking people and is a wholesome rule of conduct. It has been in effect in England for centuries without Parliamentary enactment but as Common Law. In England no regulation is provided for it; violation of it does not constitute a crime; resort to the courts is infrequent and in relatively unimportant cases. In each of these particulars the exact opposite is true of the anti-trust laws in the United States.

When the Sherman Law was enacted it read as it reads today, and for twenty-one years thereafter it was interpreted to mean that every restraint of trade, whether reasonable or not, was unlawful. That enactment put more government in business than all the statutes of Congress from the beginning of the history of the country down to the present time. In spite of many exceptions, business in general in the United States is still subject to the rule of the Sherman Law, which in actual application is not understood and is not subservient to the best interests of business and of the public.

There is necessity for a change in our laws at the present time in regard to numerous industries. For instance, the coal industry for forty years has been the football of fortune, and only for very brief, exceptional periods has it experienced prosperity. Today its condition is as bad as, if not worse than, it has ever been before. It is not only the industry that suffers;

it is the communities dependent upon that industry which suffer most. There are whole communities, as we have heard recently through the Senate Investigating Committee, in Pennsylvania in particular—and the same is true in Indiana and Illinois—which are suffering for the actual necessities of life because of the condition of the coal industry. The labor situation complicates matters very materially, but that is far from being the main reason for the difficulties in coal. Relief is needed in coal, in lumber and in oil, and Congress has indicated a way in which that relief may be granted.

Beginning in 1913, Congress started to enact laws not only granting exemption from the Sherman Law but regulating the application of the law by administrative agencies. In that year was passed the Panama Canal Act, which was the first recognition by Congress that competition could be regulated. This act entrusted the regulation of the railroads, in their ownership of competing water lines, to the Interstate Commerce Commission, a specialized governmental organization. The act established standards and in effect commanded the administrative agency to see that these standards were complied with.

In 1914 the Federal Trade Commission Law was enacted. The Federal Trade Commission was created and jurisdiction was conferred upon it to administer the rule of conduct laid down in the statute, which provided that unfair methods of competition in commerce were unlawful. This act was a recognition by Congress that competition could not of right be free and unlimited but that under certain circumstances it should be restricted.

In 1916 a noteworthy act was passed, the Shipping Board Act, which is still in effect, conferring upon the Shipping Board—please note that Congress used discrimination in the selection of its administrative agencies—the power to approve agreements in restraint of trade made between competing American steamship owners, in which they agreed as to the rates they would charge for transportation of passengers and property, allotted their tonnage and otherwise limited competition between themselves. The standard was established in that Act, that these agreements could be effective only in so far as they did not adversely affect American commerce.

There is the first recognition by Congress, that I know of, that it was possible under the Sherman Law for competitors to agree upon prices and to agree to limit their activities and the territory in which they would operate.

On the same day the Shipping Board Act became effective, the Federal Reserve Board Act also took effect, and in this Act Congress conferred upon the Federal Reserve Board the power to permit banks competing in this country to cooperate in the establishment of banks abroad.

In 1920 the Transportation Act was passed, conferring additional jurisdiction upon the Interstate Commerce Commission in the regulation of railroads as regards the consideration that they should give to competition in the determination of rates, fares and charges.

In 1921 the Packers and Stockyards Act was passed, conferring upon the Secretary of Agriculture the power to administer the stockyards of the country in conformity with the standards established in the act.

In 1922 the Capper-Volstead Act became effective, which provides in part that persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairy-men, nut or fruit growers, may act together in associations, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling and marketing in interstate and foreign commerce such products of persons so engaged, permitting them to fix prices, restrict output, and limit the territory in which they would deal. This act has not been passed upon by the Supreme Court, so far as I know, but in its decision in the Liberty Warehouse Company Case the Supreme Court refers to the act in a way in which it would probably not refer to it if it felt the Act were unconstitutional.

These, and other Congressional enactments, indicate that the view of Congress nowadays, since 1913, is that competition may be regulated, that it should not be unlimited; that individual industries may be regulated; that price agreements among competitors are proper, subject to governmental approval; and of great importance, that these regulatory or administrative activities should be committed to experts in the particular subject entrusted to their care.

We have a peculiar situation in this country under the Sherman Law as presently interpreted, in that some of our largest corporations are held not to be within the law, as the Steel Corporation, the International Harvester Company, and others; and on the other hand we have some very large corporations that have not been put to the test but which by common consent are not within the terms of the law. Yet, take the situation such as we find it in the automobile industry: one company having purchased the properties of several competing companies, is now manufacturing the cars of those competing companies and singly and by itself putting the prices upon those cars. If, on the other hand, the competitors of the General Motors Corporation, such as Packard, Hudson, Chrysler and Ford, or any group of four or five competitors manufacturing the same class of cars, were to fix their prices by agreement, even though the prices were reasonable, their agreement would be unlawful.

This situation is not serious today but it may become serious in the future. Our smaller units in industry need protection, they need an opportunity to compete on an equal basis with the larger units, and it is only by cooperation of this kind, that can easily be made effective if the government will grant the privilege, that the end can be accomplished.

The government has gone as far as it can under the law as it exists. The courts can do nothing; the executive department of government can do nothing. The only relief is through the enactment of legislation creating agencies that will administer the law for the new industries put within its provisions. In the Trenton Potteries Case, decided by the Supreme Court within the past year, it was held that an agreement among competitors fixing reasonable prices was nevertheless barred by the Sherman Law because the agreement was an unreasonable restraint of trade. The court clearly indicated, if anything was indicated by that decision, that if Congress saw fit to enact a statute making agreements of that character legal, the courts would be bound to abide by the act of Congress.

In the Cline Case, which was appealed from the Supreme Court of Colorado to the Supreme Court of the United States, a Colorado statute was involved, and the highest court specific-

ally stated that it was because the legislature had not established a definite standard, that is, had not gone far enough in indicating what agreements were to be excluded from the operation of the statute, that the statute must fail. The court used the following words: "The real issue which the act would submit to the jury would be legislative, not judicial." That indicates that the jury called upon to determine the standard had no constitutional right to do so, but that if Congress or if the legislature of the state of Colorado had established an intelligent standard, the courts would have been obliged to follow it.

There is no reason to suggest that the criminal provisions of the Sherman Law be repealed. The people are too much enamored of the Sherman Law to do anything of that kind, but as I have said, the violation of the anti-trust laws of England is not a criminal offense. No one is advocating price-fixing that I know of, except prices fixed by agreement subject to approval by an administrative agency.

That an affirmative rule of conduct can be established is perfectly clear from the fact that the Capper-Volstead Act, which I just referred to, contained such a rule, and from the further fact that the Interstate Commerce Act passed in 1887 merely provides, in Section 1, that all rates shall be just and reasonable. The Interstate Commerce Commission is given the power, and has for many years exercised the power, to administer that statute. Section 2 likewise provides that rates shall not be discriminatory or unduly preferential. Hence there is no difficulty whatsoever in finding precedents to justify the suggested legislation. I am not speaking for any organization or committee to which I belong, but expressing my personal views.

President Wilson in addressing Congress on January 20, 1914, said, recommending the enactment of the Federal Trade Commission law: "The business men of the country desire something more than that the menace of legal process in these matters be made explicit and intelligible. They desire the advice, the definite guidance and the information which can be supplied by an administrative body." That statement applies just as much today as it did then, in so far as the matters about which I have spoken are concerned, namely, agreements

fixing prices, limiting production and allotting territory, especially in the natural resource industries which are so much in need of such remedial relief.

Ours is a government of laws and not of men. If the principles upon which our legislative policy is based are sound, men of integrity, ability and vision can be found to administer these laws. The administration of laws of this character will do away with government in business and put business in government.

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A LIBERAL INDUSTRIAL POLICY

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THE generic title of this symposium, I understand, is "Present Needs in Industry." It would obviously be grossly impertinent of me to discuss the special needs in American industry; during the last four or five years, however, I have been studying on the spot industrial conditions, not only in America and in Canada, but in Japan, in India, in South Africa, in Australia, in New Zealand, and in certain other countries, and I have come to the conclusion that basically industrial problems are the same all over the world. There are superficial differences; the industries in the different countries are in different stages of development; but when you come down to fundamentals, the needs and the problems of industry are everywhere alike. Therefore if I say something about the recent developments in the relations of capital and labor in Great Britain, it is because our problems are fundamentally the same. I think it is helpful for people who are approaching questions from somewhat different angles to exchange experiences.

In Britain we are slowly and somewhat painfully passing out of a very difficult period in our industry. We have had seven years of very great industrial depression. That it should have been so is in no way surprising. England is dependent for prosperity in her industry upon her ability to export thirty per cent of the goods which she produces. When the end of the war came, we found the markets of the world disorganized and currencies debased. Our inability to supply the goods which we had been in the habit of supplying for a generation or generations, had led different countries to begin manufacturing for themselves; and then, having invested their capital in these industries, they protected them by high tariffs. Consequently we have found it extremely difficult to emerge from our depression.

Economists foretold this depression before it came. There is nothing surprising in it. I remember talking to one distinguished economist in the closing year of the war and I asked him what he thought was going to happen. He said, "We shall have a short period of dislocation, we shall have a short period of boom, and then we shall have ten years of the worst period of unemployment that England has ever known." To use a military expression, matters are proceeding according to plan. We are getting on with our ten years; we are steadily working down our unemployment. Our abnormal unemployment has been reduced from a maximum of 1,800,000 to 500,000, and every week now we are reducing it by about 25,000.

This period of adversity from which we have suffered has not been without its advantages. Adversity, they say, makes good bedfellows: certainly the adversity through which we have passed, and through which we are still passing, has led us to recognize that we really can no longer afford the luxury of fighting; that employer and employee must get together.

There has been a very striking change in the attitude of the trade unions. The change had been coming for a number of years. There had been a slow but quite steady development of a desire for cooperation on the part of the trade unions. That has been very greatly accelerated by the adversity through which we have passed, and now at the last Trade Union Congress an olive branch was held out. An offer was made to the employers: "We are willing to cooperate to increase production and to bring out better relations if you will come halfway."

That challenge was taken up by the employers. At the present time a number of the leading employers in England, representatives of all the largest industries, are meeting the representatives of the trade unions with the purpose of trying to thrash out some method of developing the spirit of cooperation and of breaking down the miserable misunderstanding which stands in the way of all real progress. I think some rather interesting developments may arise out of this conference.

When the employers and the employed get together around a conference table, each party will find very often that the

fault lies with them, when they have been in the habit of attributing it to the other party. I think that is true both of employers and of workers.

Some of us engaged in industry and interested in the politics of industry have for years been working on this problem of cooperation between employer and employed, and we have come (as you in America have come) to recognize that lasting cooperation cannot be attained by any superficial means. You cannot get lasting cooperation so long as you have two opposing forces merely seeking to maintain peace by a series of treaties. You must dig down into your problem, dig down and down until you arrive at some point where the interest of the two parties is the same, and then you must try to build up your industrial policy upon that basis. It is futile to skate over the surface of the problem, trying just to do a little bit here and a little bit there, when really the interests of the two parties are fundamentally opposed.

Now, if you dig down deep enough you come to the fact that fundamentally all industry is just service of the community. You may say, "Oh, well of course that is a platitude, and a priggish one at that." It is, however, hard fact, whether we like it or not, that fundamentally all of us who are engaged in industry are engaged in serving the community. How long could the United States of America go on without its industry? How long could our little crowded Britain go on if the industrialists, all of them, employers and workers, were to decide to shut down their plants? In a very few weeks we should starve.

Coming to a little more concise definition, I would put these three aims forward as the aims of industry:

1. Industry should create goods or provide services of such kinds and in such measure as may be beneficial to the community.
2. In the process of wealth production industry should pay the greatest possible regard to the general welfare of the community and pursue no policy detrimental to it.
3. Industry should distribute the wealth produced in such a manner as will best serve the highest ends of the community.

If employers and employed could agree upon these as the aims of industry, then on this common ground employers and employed could cooperate to try to work out in detail an industrial policy which will carry out these aims.

Your Chairman has told you of the work that has been done by the Liberal Party in England in trying to work out an industrial policy for Britain.¹ It was a very interesting and important committee that worked upon this problem. Men like Lloyd George, Sir Herbert Samuel, Sir John Simon, Philip Kerr, W. T. Layton, J. M. Keynes and Sir Josiah Stamp cooperated in this work and they produced a rather awe-inspiring volume of five hundred pages. Just before I sailed from England, a great convention of the Liberal Party, with 1500 delegates from all over the country, accepted the findings of this committee. I had a very small part in this work myself and therefore I can speak of it impartially. I think this is the best constructive thinking that has ever been done in England on the question of industrial policy.

As regards the causes of discontent in industry the committee observes:

What are the causes of this discontent which finds expression in wasteful strife or in still more wasteful restriction of effort and output? The thinking workman makes five main complaints against the existing industrial system. First, for all his toil it does not supply him in many cases with an income sufficient to give a comfortable livelihood for himself and his dependents, together with a margin for rational enjoyment and for saving.

The committee proposes an extension of the trade-board system which we already have in England in connection with a number of industries, and which fixes, after a conference between representatives of the workers and representatives of the employers with certain appointed members acting with the others, statutory minimum rates of wage below which no employer may employ a workman. The committee recommends an extension of these trade boards, and further an extension of the Whitley Councils. The Whitley Councils are councils which are created voluntarily by the trade unions and the employers in different industries for the discussion of all kinds of questions affecting the industry. The committee recom-

¹ Cf. Mr. Richardson's paper, *supra*, p. 20 *et seq.*

mends that these councils, under certain safeguards, be given statutory powers to enforce their findings. At present, being voluntary associations, they have no power to enforce their findings at law.

The second complaint that the thoughtful workman makes is:

that industry has failed to give him security of livelihood, however eager and willing to work he may be. Accident, a spell of sickness or a shortage of work due to no fault of his own, may at any moment throw him out of employment, use up his savings and inflict hardship and humiliation upon his children. Of all these menaces unemployment is the most serious and it inspires the belief that there must be something wrong with a social order in which amidst flaunting luxury such insecurity haunts the life of the worker.

You know that we have unemployment insurance in Great Britain. I know of no subject on which I hear more arrant nonsense talked in every part of the world than with regard to the working of our unemployment insurance in Great Britain. Everywhere my sense of justice is offended by hearing it being referred to as a dole. When a man who has life insurance in the Metropolitan Life Insurance Company dies and his widow collects the insurance, you do not say she is getting a dole. She is getting something for which she and her husband have been insuring for years. In the same way under our unemployment insurance scheme a man insures against the risk of unemployment, over which he has no control and for which he is not responsible, by paying every week in which he is at work sixteen cents insurance. In addition to this his employer pays eighteen cents while the state pays, if I remember rightly, twelve cents. Then, when he is out of work, the worker receives a certain proportion of his pay. This arrangement has been in operation for some years. There is not a single political party that would think for one moment of annulling the Unemployment Insurance Act. There is not a single party that is not convinced that it has been of inestimable advantage to the community during this period of great adversity.

The Liberal Party recommends that unemployment insurance shall be continued, but the party also proposes that with the purpose of lessening the volume of unemployment very

much bolder steps should be taken to develop the capital resources of the country during periods of trade depression, by constructing harbors and roads and afforestation and reclaiming waste lands so that when the period of industrial depression is over, England may be in a better position to take advantage of industrial activity when it comes along.

The third complaint that the worker makes is:

That the existing industrial order denies him the status which seems proper for a free citizen. He may be dismissed at a week's or a day's notice and thus deprived of his livelihood without redress or appeal, perhaps for no better reason than that he has offended an autocratic foreman. While as a citizen he has an equal share in determining the most momentous issues about which he may know very little, in regard to his own work, on which he has knowledge, his opinion is seldom asked or considered, and he has practically no voice in determining the conditions of his daily life except in so far as trade union action has secured it. Indeed, where management is inefficient and autocratic, he is frequently compelled to watch waste and mistakes of which he is perfectly well aware, without any right of intervention whatever, and this despite the fact that when these errors issue in diminished business for the firm concerned, he and not the management will be the first to suffer by short-time working or complete loss of employment.

The status of the worker in industry today is out of harmony with the modern conception of human relations. We talk about cooperation in industry, but if you are going to have true cooperation you must treat the worker as a cooperator and not as a servant, and that gives him quite a different status from what he had, say, twenty years ago. Twenty years ago he frankly accepted the position of a servant, and all that he prayed was that he might have a good master. In England that attitude has entirely disappeared. The worker quite definitely demands now that he shall be regarded as a cooperator, and it seems to me a perfectly reasonable demand to make.

Here we come to very definite proposals. The Liberal policy is to seek to set up machinery for organized cooperation in individual workshops and factories without impairing the necessary authority of the management. Obviously, in any properly conducted business the last word must lie with the management, but at the same time one can go a very long way in giving the worker a say as to the conditions under

which he shall be employed. We recommend that there shall be a statutory Works Council in every factory of, say, fifty employees; that every worker shall be given a written statement of the terms on which he is engaged and the terms under which he may be discharged; that one of the duties of the Works Council shall be to work out a system of works rules which shall govern the human relations in the factory; and that safeguards shall be given to the worker against arbitrary dismissal. The functions of these councils shall be mainly consultative. Experience has shown (in Germany where they already have these statutory councils and in thousands and thousands of factories all over the world where they have voluntary councils) that once employer and employed have got into the habit of sitting around a table together and discussing affairs concerning the factory, then a new spirit of cooperation grows. It really means that there shall be in a factory, not a soviet, but that there shall be government by consent.

The next point that we suggest as a cause of discontent is that:

Knowledge of the financial results of industry and of the division of its proceeds is denied to the worker and of this he is becoming increasingly resentful. He has little means of judging to what extent he is in fact participating in the fruits of his own labors or whether or no he is getting "a square deal," and his dissatisfaction with the existing order is proportionately intensified.

A good many employers in England are horrified at the thought of telling their workers what is the financial position of the business. I do not know how one can cooperate with men who have only the vaguest knowledge, or no knowledge, of whether the business is successful or not. I do not know how you can develop a spirit of confidence when the workers have no means of knowing whether they are really getting a square deal or not. When the employer tells them that he can not afford to pay higher wages, they have to take the word of the employer without knowing the facts. But surely men in business ought not to be afraid of sharing this knowledge with regard to the financial position of the business with the workers who are engaged in it.

And then finally: •

The worker believes that the products of industry are unfairly divided between Capital and Labor; that under the capitalist system society is divided into two classes: a small class of masters who own the means of production or live luxuriously by owning, and a huge class of workers who receive in return for their work only what they can force the owners to pay. He believes that under such a system there can be for his children no true equality of opportunity with the children of more fortunate classes.

The Liberal Committee did not feel that they could make any definite recommendations for statutory action in this matter, but they very strongly urged that every step should be taken to encourage the policy of profit-sharing and co-partnership. In America you have gone a very long way in this direction. I believe it is thoroughly sound. I believe it is quite unsound to think that the residual legatee with regard to the surplus profits in industry must always be the capitalist, and I am sure that the worker feels that such an assumption is unjust. If you want real cooperation then you must have a real partnership. I believe that we shall have to find some way of making the workers partners in our businesses, either by profit-sharing or perhaps better still by co-partnership, giving them stock instead of giving them cash; but in some way or other they must have an interest in the prosperity of the business in which they are engaged.

These very briefly, very crudely and very inadequately, are the lines on which liberal thought (and liberal is not used here in the political sense) is moving. I believe that the basic thing is that there shall be agreement with regard to what the fundamental aims of industry are, and I would like to see those three aims which I defined accepted by all concerned. Some may say, "Oh, those three aims are all right on a platform but they won't work in a factory; they are not practical; they are merely idealistic." But just think for one moment what such a criticism means! In our national life we would never think for a moment of adopting a policy which was merely in the interest of the strong or of a favored few. We seek to legislate in the interest of the whole community, and that is a perfectly sound thing to do.

In the development of civilization man passes through three stages. First it is a case of every man for himself—"nature red in tooth and claw." The ego is the center of each man's

universe. Then gradually and slowly man passes from that stage, until the interest of the ego is merged in that of the family and the clan. The third and final stage is when the interest of the clan is merged in the interest of the whole community. Men have not reached their full development until they reach that final stage. No nation is stably founded until it has reached it. Now, can we have a lower standard for industry than we have for our national life? The two are absolutely interwoven the one with the other. I believe that we have got to be idealistic with regard to our industry; I believe that it is only on those lines that we can possibly hope for any lasting cooperation between capital and labor. There is in mankind a steady urge upward to what he knows to be the highest and the best, and you can always appeal with confidence, in the long run, to that steady urge of mankind.

Do you remember the appeal that Garibaldi made when he was seeking to raise men to fight the Austrians? This was the appeal that he made as he went in his red shirt through the villages of Italy. "Come!" he said, "He who stays behind is a coward." "I offer you hardships, privations, wounds and battles, but we will conquer or die!". In answer to such an appeal men flocked to his standard.

And I believe that is what we have got to do. If you merely say, "I want you to work because it will pay you, because you will make money," I don't believe you will ever get the best out of men. I believe you have got to appeal to men on the highest grounds, and only on those grounds can we get lasting cooperation and peace.

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RATIONALIZATION IN INDUSTRY AND THE LABOR PROBLEM

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LAW and industry are both instrumental. They exist not for themselves. Unlike the arts, unlike the abstract speculation of thinkers, law and industry subserve purposes or they have no cause for being. And because industry is instrumental, all of us have a right to have opinions about it; indeed, informed opinion is essential if the purposes which justify industry are to be achieved.

If I remember Mr. Rowntree's words aright, he said that the problems and the need of industry are substantially the same the world over.¹ And so, one speaking from the particular viewpoint which I happen to share need only say that in substance everything which Mr. Rowntree indicated as to the needs and the social direction of industry in England applies to this country. Let me therefore only briefly repeat what he said, as coming from an American experience, not of one engaged in industry, but of one whose task, whose duty it has been these many years to concern himself with what I venture to call the instrumental aspect of industry, namely, the production of goods, and the performance of services directed toward the good life.

In this country there have been a good many investigations into industrial conditions of major account, particularly since the Pullman strike, but none as well-rounded, as comprehensive, as apt to be so enduringly fruitful, as this altogether admirable report of the British Liberal Industrial Committee.² It is fair to say, however, that the major investigations—the Industrial Commission of the 'nineties, the Industrial Commission of 1915, the reports of the President's Unemployment Conferences in 1920 and 1921, the special Hammond Committee investigation into the coal industry—in all their scope reduce themselves in their essentials to two major difficulties. If you boil down all the particulars, all the enumerations of

¹ Cf. *supra*, p. 162.

² Cf. *supra*, pp. 21, 165-169.

specific items of discontent and inadequacy in American industry, you will find they are referable to two central sources: first, the lack of scientific organization of industry; and second, discontent arising from the consciousness of workers of the disparity between the rights, the opportunities, the privileges, the exercise of faculties that they enjoy in the political world, and the lack of opportunities for controlling their economic life.

Now as to the first point, the lack of scientific organization of industry, there is a slogan which is very prevalent in England and, I think, will shortly become a catchword in America. English writers these days talk about "rationalization", which means nothing except the rational conduct of industry. That involves the elimination of waste, continuity of production, a scientific layout, Taylorism and all the rest of it—the application of systematic intelligence to the organization and conduct of industry. We have gone a good way in that direction in this country, but bear in mind that we have not begun to exhaust the possibilities that science lays open. The application of scientific procedure to any human activity is a continuous and progressive process, and implies organic treatment. And so when you come to the question of the scientific organization of industry through the elimination of wasteful methods, you must bear in mind that a remedy which merely deals with this or that defect in isolation may in its turn introduce as much harm as it eliminates.

Take for one minute what Mr. Butler was talking about, namely, the wasteful present-day organization of the coal industry: the needless number of mines; the excessive number of miners; the lack of economies due to inadequate concentration and distribution of commodities.¹ Merely to remove the restraints imposed upon industry by law would not remove the essential difficulties of industry, and particularly of the coal industry. That is part, and only a part, of the problem.

In 1918, ten years ago, the then Fuel Administrator, President Garfield of Williams College, wrote about the anthracite industry in the following language, and what was then true of that industry is even more applicable to the bituminous coal industry:

¹ Cf. *supra*, pp. 156-161; also pp. 128-138.

One general aspect of the anthracite situation was made clear which we deem very pertinent for consideration. It appears that there is lacking the basis for scientific knowledge in regard to some of the underlying facts of the industry upon which issues as to wages and output must finally be decided. Therefore, steps should at once be taken whereby systematic and authoritative information will be had in regard to such fundamental questions as comparative earnings, labor turnover, continuity of employment and sufficiency of output. We must create conditions which will assure greater continuity of employment, greater regularity of work, greater quantity of output, at the same time that we fully observe all those safeguards which should protect the workers in this hazardous industry. In a word, the conditions of the industry must be stabilized. Therefore, the attitude of mind of those in the industry in regard to those conditions must be organized.

Mr. Garfield was talking about "the attitude of mind"; not merely the *matériel*, the physical plant conditions, but the all-essential attitude of mind, or what Mr. Rowntree called the approach, which considerably affects those physical and material policies on which Mr. Butler is concentrating.

Since President Garfield wrote, we have had the Hammond Commission, headed by a man of leadership in the industrial world. Yet its recommendations remain neglected in a big volume gathering dust on library shelves. Nothing has been done to grapple with the real issues of the coal industry. The same difficulties, the strife, the cruelties, the recriminations and counter-recriminations that we have heard for twenty years or more are just as alive as they were twenty years ago. In some other industries, of course, that is not true. Rationalization along the line of scientific standards has made great headway; but until and unless progressive science is continuously in the harness of industry to produce the greatest volume of goods needed, and properly needed, by the community, with the best employment of human labor, the goal will not have been attained. I take it that Mr. Richberg (not that he has authorized me to speak for him) and Mr. Butler will both agree, although they are both lawyers, on this point: that you laymen have a right to insist that law be prompt, economic and effective in carrying out the purposes of law. Equally have we laymen in industry a right to insist that there be an application by all those who are directly engaged in industry of those procedures, those processes, those appliances and those aids which we call science, whereby industry may be conducted in

the way of rationalization. Wherever you find an accomplishment such as Mr. Dennison's at Framingham, such as one finds in various industries throughout the country, that special, unique, particular achievement must be made the clew for extension, for improvement, for general application throughout industry.

For with all our prosperity we are in great difficulty. It is probable that, although statistics are too uncertain for dogmatism, in this country there is a larger percentage, proportionately, of unemployment than in Great Britain. I know that Mr. Ford denied that there was any unemployment, when he landed in England the other day. He said, "Anybody who wants a job can get one." But those of you who have read the report of the Secretary of Labor of Mr. Coolidge's Cabinet, will remember that he reported in that delightful euphemism which statisticians as well as lawyers sometimes employ, a "shrinkage in employment" since 1926 amounting to nearly 1,900,000—"a shrinkage of employment," and the headlines all over this country reported that only 1,800,000 or almost 1,900,000 were out of employment. But as the *New York Times*, the *Journal of Commerce*, and others have pointed out, that implies that there had been no "shrinkage" up to 1926, and of course there was. We must rely on approximate estimates; we do not know for certainty. But sufficient indications lead us to conclude that in 1926 there was an unemployment of 1,000,000. The figure for present unemployment would then be close to 3,000,000. But if you cross-examine the figures of the Secretary of Labor, you will find that he based his report on the representative character of manufacturing and railroad-ing as characteristic of industry at large and used New York figures as typical—as to both these assumptions there is the greatest difference of opinion. The American Federation of Labor reports that between 17 and 18 per cent of its own membership is out of work. The guess is not too unconservative that probably the unemployment figures are somewhere around 4,000,000. Regardless, however, whether they are 3,000,000 or 4,000,000, it is plain that 3,000,000 or 4,000,000 out of a total working population of 23,000,000 is a proportion which is larger than the present unemployment in Great Britain. This is not merely a temporary condition. The

Secretary of Labor attributes it to a permanent element, at least permanent for some time to come, namely, increase in efficiency, increase in production coincident with decreased man-power. Hence we have a brand new unemployment problem in this country, that is, unemployment due to efficiency.

This brings me to the second aspect of our situation, namely, the feeling that somehow or other our vast bodies of people have not that share, or even an aliquot share, in the direction of their economic life that they have in their political life. Here again I can only agree with every word which Mr. Rown-tree said. You cannot exhort "good-will." Instruments for securing good-will, processes and institutions for making good-will effective, must be achieved, and I do not know of any means of achieving this result except to provide a permanent and authoritative channel of expression for the viewpoint, the knowledge and the interests of the workers.

I can understand quite clearly that business men should have difficulty sometimes in recognizing the right of workingmen to cooperate in an organization and to have their interests, their knowledge and their viewpoints expressed by their representatives, whosoever those representatives may be. I can understand men of self-reliance, of initiative, men who know exactly what needs to be done, not wanting to be bothered with trade-union representation. I confess, however, I have never been able to understand how lawyers, except lawyers without a sense of humor, can oppose the right of men to organize and to be represented by their own representatives, chosen however they may please, because the very nature of the legal profession is representative service. Every lawyer is somebody's representative. Only a fool has himself for a client. The legal profession is based on the right of people to have their viewpoint, their interest, represented by persons of their own choice.

There is the greatest possible waste of energy in this country in keeping alive the issue of labor organization as a fighting issue. Just as soon as you recognize the legal rightness of trade unions—and what I have said has the highest authority, at least for one in my profession, the utterance of the Supreme Court of the United States—just as soon as you recognize also the social necessity of trade unions, generously, fully, reasonably, and in action, then the whole temper of the trade unions will change; or at least we have a right to expect it to

change. Just as soon as you recognize their rights, you subject them to a responsibility for the common good and you bend both them and the employers to those common ends, to those instrumental purposes of society for which industry is organized.

The details of the kind of unions you should have, who should be the spokesmen, and so forth and so on, should be worked out as the Mond Committee in England is at present working out with the Committee of the Trade Union Conference the general considerations which Mr. Rowntree laid before us. But I believe the life of this country, its effectiveness in achieving good-will, is to a large extent poisoned, thwarted and frustrated because of the refusal to recognize generously, in action, that workingmen have the right to be represented by whomsoever they choose, and must learn by experience, as we all must learn by experience, to choose their spokesmen wisely.

Labor's right of organization being recognized, it would be incumbent upon management and men together to deal with such subtle new problems in industry in the United States as the one referred to in Secretary Davis' memorandum, that is, the vastly accelerated increase in production with a decrease in man-power. Intelligence, restraint, and good-will will be required, on the part of employers and trade-union organizations, in dealing with this new phenomenon, dealing with it always from the social point of view. If fewer men can produce more than more men produced ten years ago, then we can afford to lift our whole social level. Child labor ought to cease as a practical problem. Not only has the need for child labor, even on the manufacturer's basis, disappeared, but child labor has become destructive. We ought to deal generously with women in employment, with hours of labor, with the whole problem of relieving the burdens of present-day monotonous industry, and with the question of allowing workers to share, as Mr. Rowntree pointed out, in every aspect of productivity.

Aristotle long ago indicated that the test of civilization is the extent of fruitful leisure. As the necessary hours and days for toil lessen, we shall have to devise and maintain a dignified outlet for new-born leisure, as soon as new inventive powers and methods of scientific organization have produced for the community's needs goods in abundance.

This has been merely a repetition, applicable to American conditions, of what Mr. Rowntree has said. Let me refer you in closing to the utterance of another Englishman, a great countryman of Mr. Rowntree's. Huxley came here in 1876 to speak on the occasion of the founding of Johns Hopkins University. It was then the custom of English visitors either to marvel at our greatness or to despise our uncouthness. Huxley penetrated beneath the surface and said more than fifty years ago what I should like to leave with you now :

To an Englishman landing upon your shores for the first time, travelling for hundreds of miles through strings of great and well-ordered cities, seeing your enormous actual, and almost infinite potential, wealth in all commodities, and in the energy and ability which turn wealth to account, there is something sublime in the vista of the future. Do not suppose that I am pandering to what is commonly understood by national pride. I cannot say that I am in the slightest degree impressed by your bigness, or your material resources, as such. Size is not grandeur, and territory does not make a nation. The great issue, about which hangs a true sublimity, and the terror of overhanging fate, is what are you going to do with all these things? What is to be the end to which these are to be the means? You are making a novel experiment in politics on the greatest scale which the world has yet seen. Forty millions at your first centenary, it is reasonably to be expected that, at the second, these states will be occupied by two hundred millions of English-speaking people, spread over an area as large as that of Europe, and with climates and interests as diverse as those of Spain and Scandinavia, England and Russia. You and your descendants have to ascertain whether this great mass will hold together under the forms of a republic, and the despotic reality of universal suffrage; whether state rights will hold out against centralisation, without separation; whether centralisation will get the better, without actual or disguised monarchy; whether shifting corruption is better than a permanent bureaucracy; and as population thickens in your great cities, and the pressure of want is felt, the gaunt spectre of pauperism will stalk among you, and communism and socialism will claim to be heard.

Truly America has a great future before her; great in toil, in care, and in responsibility; great in true glory if she be guided in wisdom and righteousness; great in shame if she fail. I cannot understand why other nations should envy you, or be blind to the fact that it is for the highest interest of mankind that you should succeed; but the one condition of success, your sole safeguard, is the moral worth and intellectual clearness of the individual citizen. Education cannot give these, but it may cherish them and bring them to the front in whatever station of society they are to be found; and the universities ought to be, and may be, the fortresses of the higher life of the nation.

INDUSTRIAL ARBITRATION¹

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BY a strange anomaly of the Common Law an agreement to submit a controversy to arbitration is not binding. It is revocable. The courts will not enforce it if either party objects. For nearly three hundred years this was the rule in England, and with some exceptions it is the rule in the United States today. The Federal Arbitration Act approved February 12, 1925, provides that agreements to arbitrate shall be irrevocable and enforceable, but excludes from its operation contracts of employment of seamen, railroad employees and any other class of workers engaged in foreign or interstate commerce. The result, so far as the Federal Courts are concerned, is that an agreement to arbitrate a so-called commercial dispute, that is, one arising between business men, is enforceable, while an agreement to arbitrate an industrial dispute, that is, one arising between organizations of employers and of employees, is not enforceable.

The facts concerning industrial controversies are too well known to require recital here. Many of them culminate in warfare; many of them although perhaps terminated are never settled; in some industries the appeal to peace is not so strong as the will to war. Under existing laws there is little encouragement to arbitrate. The ultimate hope of the contenders is litigation or warfare. Either method of settlement results in stoppage of work, maladjustment of business, financial loss to both parties and injury to the public.

For several years the Commerce Committee of the American Bar Association has been conducting an investigation and making an intensive study of conditions in the realm of industrial controversy in the hope that some substitute for warfare might be found. From the record made before the Com-

¹ This paper was read by title at the Semi-Annual Meeting of the Academy of Political Science, April 11, 1928.

mittee it seems to be the consensus of opinion of specialists on the subject as well as of industrial managers and labor leaders that agreements containing arbitration clauses make for peace in industry, and that under them the courts will function not more than they do now, possibly less. P. W. Martin, research worker in the International Labor Office, in outlining a program of procedure, said that the best method of cooperation between employer and employed seems to be one which provides: first, for the prevention of disputes, that is, for a continued collaboration of the two sides, a collaboration broader than could be built merely on the settlement of disputes, a collaboration based on common interests of the two parties; second, for machinery set up in advance; and, third, for the most desirable form of settling industrial disputes, namely, by agreement of both sides made in advance to submit all controversies to arbitration as the last resort.

The primary concern of business men in this matter lies largely in agreements to submit *future* disputes to arbitration. It is far easier and simpler to obtain such an agreement as a part of the original contract of relationship between employer and employee at the time when the parties are in accord, than to come to such an agreement after contention has arisen between the parties.

Arbitration is even more applicable to the industrial than to the commercial field, because in the latter one is dealing largely with dollars and cents, whereas in the former one is dealing with human relationships.

Among the advantages of such an agreement to the employer (outside of the fact that it is enforceable) are that the employees waive the right to strike pending the award, that labor conditions are stabilized, and that a better class of employment and employees is assured.

The essentials of the agreement are: (1) that it shall be irrevocable; (2) that it shall constitute a defense to court proceedings; (3) that in the event the parties fail to name the arbitrators in accordance with the agreement, they may be named by third persons or agencies, such as the court; (4) that performance of the agreement to arbitrate may be compelled; (5) that the courts shall have power to enforce the award; and (6) that during the period of the existence of the agreement there will be no interruption of industry.

It is also essential that the arbitrator be chosen by the parties, and not by a stranger to the arbitration agreement, unless by reason of the failure of one of the parties to make a choice. This point is insisted upon strongly by those interested in the arbitration program. It is also urged that it is of great value to submit all controversies in an industry to one arbitrator or board of arbitrators who shall decide all disputes. This gives the contending parties the benefit of special knowledge and experience, and tends toward stabilization of their industry.

Mr. W. Jett Lauck, a distinguished student of labor conditions in this country who acted as economist for President Wilson's commission on industrial relations, heartily concurred in the idea of enacting state and federal legislation making agreements to arbitrate enforceable. He said it would afford protection and stability to both employers and employees as well as to the public.

From an exhaustive record made before the Committee on Commerce, the Committee has arrived at the definite conclusion that the time has come when provision should be made for the settlement of industrial controversies along economic instead of military lines. While I cannot at present speak for the Committee, at least one member of it is convinced that the first step in a remedial program should now be taken, namely, the enactment of federal legislation making irrevocable and enforceable all agreements between employers and workers to submit their differences to arbitration. There is a strong public demand for such legislation. No complaint has been made before the Commerce Committee as to the merits of the proposal. Employers' and employees' representatives and experts in the field of industrial study and investigation have approved it. William Green, President of the American Federation of Labor, in commenting on the activities of the Commerce Committee, said: "If we can create a state of public mind favorable to effective cooperation and industrial peace, we will have achieved a most worthy purpose and object." The eminent counsel for the National Association of Manufacturers, James A. Emery, has expressed the view that with the acceptance by all concerned of the responsibilities imposed by it, the suggested legislation would

be a great step forward. Matthew Woll, Vice-President of the American Federation of Labor, has expressed the view that an agreement to arbitrate, when freely and voluntarily made, should be given legal sanction. He has stated that the parties should be at liberty "to determine at the time of making such agreements the methods by which such contractual obligations should be enforced and if violated by either of the contracting parties to determine the measures to be resorted to by the injured party in removing the violation of the contract without bringing into these issues the courts or burdening them with these industrial problems Decisions would have the status of law."

Charles L. Bernheimer, whose large experience in actively promoting the enactment of the federal and New York arbitration statutes gives his opinion the highest value, says that arbitration is the most humane form of adjusting differences, that it is a moral and ethical proposition. He favors the irrevocability of agreements to arbitrate when freely and mutually entered into in advance of dispute. The arbitration must be voluntary as opposed to anything that even savors of compulsion. Given the sanctity of a contract, such an agreement becomes a private law, so to speak, between the parties making it. He believes the attitude of business men as well as of workers throughout the country is favorable to the proposal. There is a growing tendency to depend upon tribunals created within separate industries to solve industrial problems. "Democracy in education has brought about democracy in industry." There is an ever-increasing demand for a form of self-government in industry within but not in any way above the law. Men have come to believe in less government in business. Industrial self-government is a practical ideal.

Some of the beneficial results obtained in those industries in which arbitration has been effective under the provisions of the New York statute making agreements to arbitrate enforceable are a matter of record. There are several sets of arbitration machinery in active operation in the needle industry. One such set has registered approximately six thousand complaints coming from both manufacturers and employees since June, 1924. Of this number, not more than one hundred and twenty-five cases, or two per cent of the total,

have reached the impartial chairman for his action, and less than ten per cent of these, or two-tenths of one per cent of all cases, were actually decided by him. There has been no strike or lockout in the industry since the arbitration machinery was first put in motion. In another association in the needle industry three thousand complaints were filed, of which only about one hundred and fifty came to the impartial chairman, all of which were decided. In no case has either side failed to carry out his decision. Counsel for one of the organizations stated that the decisions under the arbitration arrangement built up what he referred to as the "common law of the industry," and that with the establishment of precedents the settlement of controversies was effected almost without delay.

The impartial arbitrator in one of the needle industries said that the big thing in the idea of industrial arbitration is not so much the creation of a common law of industry as the creation of a state of mind that makes it possible for employers and employees to get together in a favorable atmosphere. One of the results of the arbitration program is that production is speeded up. Production has been increased in every shop of his entire organization. There is no penalty in the arbitration agreement for failure to abide by the award of the impartial arbitrator, but his award is always obeyed. There is no danger that any man in the union, or any party to the arbitration will dispute the judgment of the impartial chairman.

The operation of the arbitration machinery in the needle industry in New York has received favorable commendation from Julius Rosenwald, who says, "I am convinced that it is achieving excellent results." J. D. Lit of Philadelphia says, "The New York clothing industry is to be congratulated on having the vision and foresight to provide in advance the means of adjusting labor disputes. Incalculable loss to manufacturers and workers alike is avoided by the system of arbitration as represented by the impartial machinery."

William P. Goldman says, "We have demonstrated in the past three years to the retailers of the country that a continuous peace prevents violent fluctuations in prices and stabilizes costs, and, what is of prime importance, our method insures continuous and uninterrupted deliveries."

So far as I know no objection has been raised to the proposal to enact federal legislation. A word of caution has been expressed to the effect that progress be made slowly for fear that the suggested legislation may be construed as an invitation to workers to organize. The fact that some of the largest industries in the country which are without labor organizations have in effect such a program for the adjustment of industrial controversies seems to be a complete answer. In one of the largest packing concerns in the country in which the workers are unorganized, a complete system for adjustment is in effect and has been so productive of results that the machine has not been called upon to operate. All troubles have been settled without the necessity of action by the arbitrators. The very existence of the machine is in itself a safeguard against controversy. The workers are enthusiastic in their support of it.

There being no objection to the proposed legislation on its merits, why should its enactment not be immediately demanded of Congress? Minor objections should not lead us from the consideration of the main question, "Is industrial warfare to continue as the order of the day, or is a step to be taken toward its permanent eradication?" Are conditions so satisfactory now that the situation may be made worse rather than better by the enactment of legislation? The present proposal tends to create the will to peace. The *laissez-faire* doctrine can do more to retard the approach of peace than can the opposition of all the world's radicals.

The proposed legislation maintains inviolate the principle of freedom of contract. The arbitration proposed is voluntary—not compulsory. Neither party can be required to agree to arbitrate and arbitration cannot be demanded of either in the absence of agreement to arbitrate freely and voluntarily made. Fraud or compulsion when inducive to the execution of the agreement nullifies it. No agreement so made will be enforced by the courts.

It is not necessary to condemn either the courts or judicial administration in order to justify the suggestion that the settlement of group controversies be made outside of the courtroom. The very word "litigation" is offensive to many. Even some lawyers dislike it. The due process of law guaranteed by the Constitution requires many formalities in pro-

cedure, necessarily causing delay, with its attendant inconvenience and expense, and occasional miscarriage of justice. Industrial controversies are peculiarly capable of speedy settlement. Arbitration might end many controversies before court proceedings could be instituted and many controversies are incapable of proper settlement by process of law. Most industrial disputes have their origin in industrial customs and practices with which courts and juries are wholly unfamiliar. It is safe to say that in most such cases more speedy and more exact justice can be done by an impartial arbitrator chosen by the parties. It has been said that an impartial arbitrator takes the place of a mediator rather than a judge.

There is no thought of abolishing the power of injunction in the courts. On the contrary, the award of an arbitrator is, in the language of Mr. Woll, to "have the status of law." This means that the award is legally enforceable. There is no question that the court will have the power to give effect to an agreement to arbitrate by requiring submission on the part of either party in default.

Even though no machinery for the enforcement of arbitration is contained in the agreements of the needle industry of New York, the existence of the New York arbitration law and of the agreements made enforceable by it has had a moral effect on the general industrial situation. It is doubtful if the manufacturers would have entered into the arbitration agreements if they were not known to be binding and enforceable. The present satisfactory conditions of the needle industry of the State of New York are due to the New York Arbitration Law enacted in 1920.

There are almost as many forms of machinery for arbitration as there are agreements to arbitrate. General provisions to submit to arbitration with the safeguards herein suggested are sufficient in practically all cases. The working-out of the details should be omitted, so that it may be possible to meet the conditions within each industry.

MUTUALISM

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IT is a great pleasure to discuss a non-controversial topic in the indolent hour that follows the efforts of a competent dietician to provide a non-controversial dinner. The bitter conflicts of opinion over religion, politics or sport will not arise to plague us this evening. Mohammedans, Buddhists, Pantheists, Atheists and Christians, early or late, wet or dry, can dwell together in unity. Republicans, with or without oil, Democrats, with or without beer, can stand on the same platform. The envenomed partisans of Gene Tunney and Jack Dempsey can count the seconds in unison and shake hands across the bloody chasm of the second civil war.

Tonight we meet in harmony of spirit to consider a subject of common interest, to advance a common purpose, to answer a common question; "How can we all make money?" The question comes to us jingling down the ages. Strangely, it is a question which has been answered more successfully each century. Other great questions have seemed to grow harder to answer. This one has become easier. Religion, politics, sport, art, science and education have presented their great questions in every age; but the answers are harder to find to-day than two thousand years ago. We know now that we know much less than we thought we knew, when we knew very little.

But the great question of commerce and industry grows easier to answer as the world grows older. Once it was believed that we could not all make money. It was thought necessary for most people to suffer and starve in order that a few very choice people might appear in the moving pictures of Nineveh. It was thought necessary to postpone the common acquaintance with gold until after death, when a rather large city with real gold pavements would be ready to accommodate those who had accepted the inevitable miseries of life without constantly complaining to the managers.

With the passage of time the number of the choice people who could really make money has steadily increased. The wealth of the noble few soon increased, so that more and more assistants were required to handle it. The inevitable result was that around the very choice nobility developed a rather choice circle of retainers; and around these developed a less choice circle of commercial gentlemen; and eventually around the commercial gentlemen developed a larger and more indiscriminate circle of those who, because they actually made a little money now and then, were called the "aristocracy of labor".

During each stage of this widening of the circles of money-makers, the answer to the question, "How can we all make money?", became easier, until at the beginning of the twentieth century the answer was so plainly written in the history of industry that even a few professional economists began to hint that it might be possible for everybody to make money. With customary caution, however, these advanced thinkers pointed out that such a result must come from the operation of economic laws and could not be brought about by any efforts of humanitarians to interfere with the laws of nature, which ordained that the strongest hog should always be the fattest. At the same time, fortunately, some political scientists discovered that both hogs and the economic laws of hogs were the product of society and government, which likewise could produce human beings and their economic laws. Even some of the white-rat-and-guinea-pig school of biologists conceded that *homo sapiens* was *sui generis*—or, in newspaper English, the less you think about hogs the more you will know about men. Advocates of restricted immigration and birth control have offered, for example, measures of self-protection which do not affect the economics of the pig pen. Thus it came about that some time after the world war many influential persons in America became convinced that modern industry held a solution for one age-old problem and a final answer to the question; "How can we all make money?" It was not only admitted but proclaimed by economists that man's productive capacity in the United States had now caught up with and passed his subsistence needs. The achievement described colloquially as "making money" is, of course, the

gathering of more coin than must be spent at once to satisfy subsistence needs. It was now apparent that industry could produce a surplus over necessities for every worker.

The first reaction of many business men from this demonstration was an increased zest for foreign investment. It was true that American industry could still absorb a great deal of new capital. Yet, when the beneficent results of industrial progress in this country became visible to our business geniuses, the zeal for foreign missionary work followed inevitably. In the past, even when our city slums still moaned and prayed for Christian charity, we have generously spent millions of the surplus product of American labor to persuade the heathen in his blindness to cease bowing down to wood and stone, showing him the superior virtues of steel and marble. Even before elections in Chicago, Philadelphia and many other places, had become entirely safe for democracy, we had sent the army and navy to other countries to guarantee free elections and a conservative government.

The urge to help other people, even before our own people are taken care of, has long characterized the philanthropic leaders of American industry. Thus the rush of American money abroad was not surprising, after it became apparent that everybody could make money at home, if the industries of America were operated for the benefit of all the people of America. "Send the glad tidings far over the sea"—is a line from an old song that expressed the first notable response to the revelation of our industrial power. But the increase of foreign investment brought a host of new distressing problems. Foreigners could not pay interest on these investments, except by sending us their products and we had erected tariff walls to keep out these foreign products. With unexpected and embarrassing candor a group of bankers, realizing that foreign products must come in to pay interest on foreign loans, suggested that the tariff walls had better come down. Indignant captains of industry shouted back that foreign investments had better be summoned home—that they had joined foreign legions and were attacking the fortifications of their native land.

It is hard to tell what would have come of this fratricidal strife between American money at home and abroad if it had

not been for the genius of Aristides Midas, the great banker who called the first conference to consider "Mutualism". This was held shortly after the conclusion of President Coolidge's second term; the exact date now escapes me.

The program of Mutualism that developed out of that historic conference is presumably well known to all of you. The results of that program in the subsidence of industrial warfare and the consequent unprecedented prosperity of American industry are equally well known. But until this evening the opening address of Mr. Midas to the conference has never been made public. Through the courtesy of an investigating committee of the Senate, I have obtained a stenographic transcript of that address, which I will present herewith in condensed form.

It will be clear at once that the dogmatic generalities of Mr. Midas carried conviction only because of the speaker's personality and the vigor and financial power with which he supported his conclusions in subsequent discussions. I dare say that his remarks would arouse more dissent than approval in any such gathering as this today had not mutualism proved itself. We were all agreed that Henry Ford could not do what he did—until he did it. And when Aristides Midas proposed to out-Lincoln Henry Ford, he did not expect the immediate approval of his friends. He began his remarks as follows:

"Our future prosperity and happiness are menaced by many causes which all have their roots in one cause, the antagonism between management and labor. It has been and is the job of managers to coordinate the contributions of property-owners and workers. They have offered for money—indefinite profits and insecurity, or definite interest and some security. They have offered for men—wages and no security. They have explained their failure to satisfy either group by the demands of the other group, thereby making each group fear and dislike the other group, and increasing the difficulties of co-operation between them, and preventing a more effective co-ordination of their contributions.

"As a result, management has ceased to be the servant of capital and it refuses to serve labor. It has just become a self-blessed autocracy, that serves itself. Two things which

we need to protect in this country are the freedom of property and the freedom of labor—not one, but both. If property owners have brains enough to hang on to their own money and wage-earners have brains enough to hang on to their own labor, they must have brains enough to see that if they let management keep them apart, they will both lose out. If they work together, they can run the show.

“Now how did this thing happen?” asked Mr. Midas. And then he answered: “It was inevitable. Some gang has always run the show since we began to experiment with this game called civilization—a gang of kings or priests or barons or merchants or bankers. Now we have a gang of managers. I’m one of them. I know the gang. We don’t run the show with our own money, although we have plenty for ourselves. We run the show with other people’s money. Somebody has always done that. We are doing it today. It has been a great game. But I know a better game. I’m going to tell you about it.

“The eighteenth century is dead. The nineteenth century is dying. We and our children must live in the twentieth century. The dead and dying ideas of past centuries don’t fit the living facts of this century. The old individualism in industry has passed away. Collectivism is a universal fact. Corporate organization dominates the scene. The ideas of eighteenth-century individualism no longer fit our needs. The ideas of nineteenth-century socialism never did fit our needs. The twentieth century demands mutualism, that is, genuine cooperation between property-men and labor-men in developing a common program for the benefit of everybody, and the employment of managers to carry out the program.

“First. We should expurgate from our libraries all the writings of Karl Marx and his disciples. The doctrine of the inevitable class struggle which has impregnated the minds of financiers and business leaders has been proved unsound; and it is a serious impediment to social progress for the owners and managers of industry to continue to look upon the workers as a hostile class of society. Fortunately, the vast majority of workers in America have never adopted the Marxian philosophy, but have advocated cooperation. Therefore, if cooperation is now advocated by property-men, a cordial response from labor-men is assured.

"Second. Why do we need cooperation? Money has always been able to hire brains. Why stop to be polite and to confer and consult? Why not go on buying what we need? We know the market price of muscle and brains and genius. We can buy all of these things that we need. But—we have recently discovered that the game has become too easy and that all the fellows who really count are bored with it and are looking for other games to play. Many of them even prefer golf. It's only the raw, uneducated crowd of would-be-managers that are getting a thrill. That's why I'm here to propose a new game—because I want to have a good time again before I die.

"Third. Why is the old game too easy now? Because competition in the production and distribution of staple goods and services has outlived its usefulness as an entertainment for ambitious men. Before we were able to produce enough necessities to assure everybody a decent living a fight for subsistence was inevitable. Until we could get all that we needed, our kind would fight to get all that we could. But after we have more food and shelter and clothing than we can use, what do we want? Peace of mind—happiness—something to do that is a good game. There isn't any fun in taking food and shelter and clothing away from other people, is there? How many people will admit that they enjoy that game—in the twentieth century?

"We can now produce and distribute among the people of the United States all the staple goods and services they need. There's no reason to fight over that job—any more than to fight over supplying water in our cities. We ought to organize money and men to do the job completely and to do it better than we're doing it now. But there's no sense in fighting over it. When we could only produce a thousand good homes for every twelve hundred families, even a Quaker had to fight. But now, when we can produce twelve hundred good homes for every thousand families, we ought to get together so as to do the job as well and as quickly as we can and then fight about something worth fighting about, so that we can enjoy the struggle. I've lost all enjoyment of making money out of misery and I've lost all respect for men who are willing to do it.

"Fourth. Competition in improving old services and in producing new services is the game for this century. We used to buy crackers out of a barrel, soggy and dusty and broken. Now we buy them in boxes, crisp and clean and whole. That's progress—if we don't pay ten cents for two cents worth of crackers. We used to go to lots of trouble and stand lots of boredom seeking entertainment and relaxation. Now we can turn on the radio—and thank God! we can turn it off. That's progress—if we don't pay a hundred dollars for a ten-dollar instrument. There are fortunes still to be made by men who will improve an old service or produce a new one. But there isn't much competition and adventure, and there ought not to be any real money-making in just doing the same thing over again in the same way. Standardized pay is enough for a standardized job. No reason why a man should get wealthy making and distributing the same old bread and shoes and pig iron in the same old way.

"Fifth. How are we going to develop in the twentieth century the new decent competition in giving service and get rid of the old indecent competition in grabbing things, which was once inevitable and is inevitable no longer? We need, at the outset, to recognize one simple principle. If we want to do a man a service, the first thing to find out is what he wants. I think I hear some one asking with a sneer, 'Who is the object of this noble inquiry?' And then I think I hear his neighbor reply with mock solemnity, 'The ultimate consumer'. Well, that's not my answer. I've never been able to locate an ultimate consumer. But I've never yearned to serve those people who seemed to be nearly ultimate consumers—such as the alimony ladies and male butterflies of Florida and New York.

"Most of the people who are called consumers are primarily workers. They work before they consume and they consume according to the market value of their work. If we find out what the workers want to work for, we will find out what consumers want to consume. In proportion as we satisfy the workers we will satisfy the consumers—for they are the same persons. All of which shows that if we had an adequate and comprehensive organization of labor we would have the means of determining and satisfying consumer demand to an extent heretofore impossible. The prime need of the present time is universal and effective labor organization."

At this point in Mr. Midas' address, I am informed that five members of the conference were stricken with apoplexy and that a score of others fled gasping to the outer air. After a short recess the conference reassembled in a more liberal atmosphere; Mr. Midas remarked parenthetically that hardened arteries in the brain were peculiarly dangerous to individuals and to society, and then continued his demand for bigger and better labor organizations.

"I have not become an advocate of industrial unionism or company unionism or trade unionism or any particular form of unionism", he said. "I have become an advocate of natural and universal labor organization, because I have come to see that we can't do a good job investing money or managing property without the aid of adequate labor organization. Furthermore, I want labor organizations to run themselves, so they will be forced to accept some responsibility in balancing labor power and consumer demand. I know that I don't know enough to do the job alone and to do it right. I know that no group of men can advise me adequately unless they include the actual and responsible representatives of labor power and consumer power.

"The managers of industry today ought to be statesmen, because the welfare of the country rests upon their larger decisions. Not merely physical well being, but social policies and social ethics are determined by those whose power over the standards of daily living is greater than that of government. But it is democratic statesmen we need, not dictators. Does any man here doubt that the forces moving in modern life and the powers available for human direction are too great and too complicated to be safely controlled by any one man or any small group of men? Does anyone think that any sane man or any small group of sane men would aspire to dictatorship in the modern world? A would-be dictator must be inspired by delusions of grandeur, willing to seize the thunderbolts of Jove, reckless of when or where he may unloose a storm to devastate the land.

"I hold no brief for any leader of organized labor", said Mr. Midas, "least of all for any who think and talk about dictatorships. The labor autocrat and the property autocrat are alike the foes of industrial cooperation. They are broth-

ers under—and in—the skin. I am not enamored of traditional trade unionism, because although there is still a field for craft organization, it is only a part of the labor field and the technique of traditional trade unionism is often an impediment to effective organization. But there are at least two great virtues in trade unionism that should be emphasized and are fundamental to sound labor organization: first, the organization of those of immediate common self-interest; second, the organization of self-governing small units and the federation of these into larger units whereby wider common self-interests may be conserved. The workers of a craft, the employees of one employer, the wage-earners of one industry, have various common interests. Factory workers, mine workers, agricultural workers, are larger groups that have some common interests and include many separate interests. Employers, managers and investors have similar interests in small and large groups. They organize now to express these interests and they will organize more effectively when more intensive organization of labor stimulates them.

“Many leaders of organized labor and organized capital have long agreed that the Sherman Anti-Trust Law should be repealed. I would go further and say that all such anti-combination laws, written in the legislatures and the courts, should be wiped out and that organizations and combinations of all forms of self-interest in industry should be encouraged, so that organizations of economic power may provide natural balances of power and may deal freely with each other, each conscious of its strength in what the members have to give, and conscious of its weakness in what they must seek from others.

“We are in fact utterly dependent upon each other in modern society. The man seeking only a few services from his fellow men realizes necessarily only a few of the possibilities of modern life. The fuller the life we lead the more we need the services of others. If we will provide ourselves with the means of mutual exchange of information, and mutual understanding of different points of view, we will be able to obtain for ourselves and for others much more satisfaction out of life than will be possible so long as we deny ourselves the means of such an interchange.

"Permit me to summarize, in a few words the choice we face in meeting the needs of industry. If we organize other men to serve our purposes we make ourselves responsible for the consequences to them, for the misery or happiness of their lives; and they are relieved of responsibility for the consequences to us. They owe us no debt of gratitude for having taken away their liberty, which is more precious than anything we may give back. It is only when we are all freely organized to serve our own purposes that we become responsible for ourselves and mutually responsible to each other. That it what I call mutualism."

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PROCEEDINGS
OF THE
ACADEMY OF POLITICAL SCIENCE

Volume XIII]

JANUARY, 1929

[Number 2

THE PRESERVATION OF PEACE

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE ANNUAL
MEETING OF THE ACADEMY OF POLITICAL SCIENCE IN THE
CITY OF NEW YORK, NOVEMBER 23, 1928

EDITED BY
PARKER THOMAS MOON

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COLUMBIA UNIVERSITY

1929

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PREFACE

THIS volume deals with the most momentous politico-economic problem confronting mankind. With weapons rendered ultra-destructive by advancing science, modern warfare has not only ceased to be a profitable instrument of national policy; it has become a tragedy even for the victor and a peril to the world-wide economic fabric, massive but delicate in its complexity, upon which contemporary civilization has been reared. Many thoughtful persons have asked themselves with the British Prime Minister, "Who in Europe does not know that one more war in the West and the civilization of the ages will fall with as great a shock as that of Rome?" Pessimists may perhaps derive a pallid pleasure from such a prospect, but public-spirited men and women, the world over, regarding the peril as a call to action, recognize the justice of President Coolidge's terse warning: "If this generation fails to devise means for preventing war, it will deserve the disaster which will surely be visited upon it".

In the urgent task of devising means for the prevention of war, the government of the United States has found itself embarrassed by the difficulty of formulating the terms of international coöperation in a manner compatible, in the opinion of the necessary two-thirds of the Senate, with the Constitution, the traditional policies and the interests of the United States. This difficulty has held America aloof from the principal existing agencies for the preservation of peace and the promotion of international welfare, namely, the League of Nations, the International Labor Organization and the World Court.

In the negotiations, however, which led to the signing of the Pact of Paris, the United States Government was able to discover a new basis on which, it seemed, America might be able not merely to join with the other nations of the world, but to regain a position of courageous leadership, in doing away with war. For this reason, if for no other, the Pact must be of peculiarly vital importance to America.

Still greater significance, however, will be seen in this singularly short but far-reaching treaty if it is viewed in a longer perspective. In the words of Dr. Nicholas Murray Butler, it

"marks the longest step forward since the noble movement to lift civilized nations above the barbarism and cruelty of international war began. . . . Its weight and its value in fixing national ideals and in shaping national policies cannot be overestimated".

To clarify public opinion respecting the terms and meaning of this historic document, and to bring together experts in history, politics, economics and international law who would best be able to estimate its significance, appeared to be the most signal public service that the Academy of Political Science could render at this time.

Accordingly, the Annual Meeting (Forty-eighth Year) was devoted to the topic, "The Preservation of Peace". Three sessions were held, in the morning, afternoon and evening, respectively, of November 23, 1928, at the Hotel Astor in New York City. The addresses and discussions were heard by unprecedentedly large audiences and are now made available, in this volume of PROCEEDINGS, for a still wider circle of readers.

At the close of the dinner session, the President of the Academy, Dr. Samuel McCune Lindsay, summed up the discussions and made a brief but telling declaration of his personal conviction regarding the Pact. His statement may well be quoted here, not only as a commentary on the meeting, and as an introduction to this volume, but also as an effective argument for the ratification of the treaty.

DR. SAMUEL McCUNE LINDSAY: Ladies and Gentlemen: I am not going to ask you to listen to another address at this closing moment of our annual meeting, but I do want to say just a word. First of all, I want to thank you all for your attendance at the meeting this evening and at the sessions during the day. Your presence here tonight and the presence of the large audiences both this morning and this afternoon attest the great interest that is felt in this problem that we have had under discussion.

I want also, on your behalf, to thank the speakers, first of all the speakers to whom we have listened with so much interest and profit this evening, and also the speakers to whom we have listened during the day. I doubt very much whether in the whole history of the Academy we have ever had a group of fifteen or twenty addresses and papers in which we can take more pride than those that have been presented here today, and I am very sure that the volume which will present those papers

to a wider public will be one in which we will take still greater pride and render a very real service to our fellow-citizens both in the Academy and in the greater audience outside.

We have never passed resolutions or attempted in any way to dictate either to our own members or to our fellow-citizens how they should act on the questions that we have discussed. In this meeting we have perhaps to a greater extent than ever before attempted, for the purpose of clarification, to present one side rather than to debate on all possible sides of the question under consideration. We have attempted to analyze first the part of the treaty that dealt with the principle of the renunciation of war. That was done in a very remarkable group of papers at the morning session by experts and scholars who brought to us very generously of the results of their studies. This afternoon we discussed the second part of the treaty before us, namely, the peaceful settlement of international disputes, and this evening, the general principles underlying the treaty itself.

There is just one concluding word, not by way of advice or recommendation but merely as an expression of my own personal conviction, that I would be glad to leave with you. It is my answer to the question:

WHAT SHALL WE DO WITH THE PACT?

This question now squarely confronts every man and woman in the United States. It confronts the President and the government of the United States and it will soon confront the United States Senate. There is but one answer for the present if we value more highly than anything else our national honor and good faith. That answer is: ratify without reservations or only with such reservations as will clarify, if that be necessary for an instrument that is exceedingly clear and simple, and not arouse doubts and suspicions about our attitude toward and desire for world peace.

Some will say the Pact is only a gesture or at most a moral aspiration that gets us nowhere. Others say that without sanctions of new machinery which it does not provide, for the peaceful settlement and resolution of international differences and interests, it may only lull the world into a sense of false security and delay the real work that must be done to build real foundations of peace. Still others will have reasons for hesitation concerning the full and frank acceptance of the Pact for what it is and for what it is worth, but I have yet to hear a sound argument advanced to show that there is any positive harm in the Pact as it stands. This is no time to discuss the relative degrees

of merit that it may possess. The time for that will come after ratification, when in a new spirit and under new possibilities of international coöperation we can work out with the other great Powers who will also ratify this Pact the ways and means of interpreting and applying it in order that it may become the chief cornerstone of a new structure of world peace. It is not that structure at present and was not intended to be more than a practicable foundation for such a structure.

For good or for ill, whether intentionally or unintentionally on the part of our government, this Pact, originating on the remarkable initiative of the responsible Foreign Minister of the French Republic, M. Briand, as it stands, has been labelled the world around and by common consent, in which we have acquiesced, an American proposal. If we fail now, as a matter of common honesty, national honor and international good faith, to ratify it for what it is worth, be that much or little, there will be no other basis or foundation for a generation at least upon which to build any structure of world peace. We shall face nothing but international anarchy and moral disaster. Therefore I do not hesitate to say that the issue of ratification must be lifted above all partisan political considerations, above all honest differences of opinion concerning the merits, demerits and potentialities of the Pact, and that the highest patriotism and the hope of the world impose upon us, as upon the other nations that have signed the Pact, the solemn duty of prompt, unqualified and generous ratification. This is the only hope that the statesmen of the world may be able to chart the course and indicate the next steps in the path of peace and international coöperation in a world where war has been renounced as an instrument of national policy.

The program of the Annual Meeting was as follows :

PROGRAM

FIRST SESSION

Friday, November 23, 1928, 10 A.M.

North Ball Room, Hotel Astor

TOPIC : The Renunciation of War as an Instrument of National Policy

PROFESSOR E. R. A. SELIGMAN, *Presiding*

1. *World Peace and Economic Stability.* PROFESSOR E. R. A. SELIGMAN, Columbia University.

2. *History of Peace Proposals Beginning With the League Covenant.* PROFESSOR WILLIAM E. LINGELBACH, University of Pennsylvania.
3. *What is "War as an Instrument of National Policy"?* PROFESSOR JAMES T. SHOTWELL, Columbia University.
4. *The Effects of the Abolition of War Upon National Commercial Policies.* PROFESSOR BENJAMIN B. WALLACE, of the United States Tariff Commission and Georgetown School of Foreign Service.
5. *The Effects of the Abolition of War Upon National Banking Policies.* MR. W. RANDOLPH BURGESS, Federal Reserve Bank of New York.
6. *Public Opinion and the Renunciation of War.* MR. WALTER LIPPMAN, of *The World*, New York.
7. *Discussion.* MR. JOHN STRACHEY, of *The Spectator*, London.

SECOND SESSION

Friday, November 23, 2:30 P.M.

Rose Room, Hotel Astor

TOPIC : *New Uses for the Machinery for the Settlement of International Disputes*

HON. GEORGE W. WICKERSHAM, *Presiding*

1. *Introductory Address by the Presiding Officer.* HON. GEORGE W. WICKERSHAM, former Attorney-General of the United States.
2. *The Pact and World Politics.* PROFESSOR PARKER THOMAS MOON, Columbia University.
3. *The Pact and Business.* MR. JOHN H. FAHEY, publisher of *The Worcester Post*.
4. *The Settlement of Justiciable Disputes by Arbitration and International Courts.* PROFESSOR JOSEPH P. CHAMBERLAIN, Columbia University.
5. *The Settlement of Political Disputes Through Conference, Conciliation and Diplomacy on a Business Basis.* MR. DAVID HUNTER MILLER, former Special Assistant, Department of State.

6. *Discussion.* MR. ALLEN W. DULLES, of Sullivan and Cromwell, formerly member of the American delegation to the Preparatory Disarmament Commission. DR. STEPHEN P. DUGGAN, Director of the Institute of International Education.

THIRD SESSION

ANNUAL DINNER MEETING

Friday, November 23, 7 P.M.

Grand Ball Room, Hotel Astor

**TOPIC : *The Preservation of Peace—
The Pact of Paris***

HON. NORMAN H. DAVIS, *Presiding*

1. *Peace and World Trade.* HON. NORMAN H. DAVIS, former Assistant Secretary of the Treasury and former Under Secretary of State.
2. *The Case for the Pact.* HON. ARTHUR CAPPER, United States Senator from Kansas.
3. *Peace and World Prosperity.* HON. ROY A. YOUNG, Governor of the Federal Reserve Board.

There follows a brief "Who's Who" of the speakers who contributed to the program :

EDWIN R. A. SELIGMAN, PH.D., LL.D., a member of the Board of Trustees of the Academy of Political Science and McVickar Professor of Political Economy at Columbia University since 1904, presided at the morning session. He is editor of the *Encyclopedia of the Social Sciences* now in preparation and author of *The Shifting and Incidence of Taxation*; *Progressive Taxation in Theory and Practice*; *Essays in Taxation*; *The Economic Interpretation of History*; *Principles of Economics*; *The Income Tax*; *Currency Inflation and the Public Debt*; *Essays in Economics*; *Studies in Public Finance*; *The Economics of Installment Selling*; and other important works. Professor Seligman has been called upon to act as an expert adviser to numerous municipal, state, and national bodies, to the League of Nations committee on economics and finance and most recently to the Chinese Government.

WILLIAM E. LINGELBACH, PH.D., has been Professor of Modern European History at the University of Pennsylvania since 1908 and has served as president of the History Teachers Association of the Middle States and Maryland, as a member of the Council of American Learned Societies, the Council of the American Historical Association, the National Board for Historical Research. Among his publications are: *The Doctrine and Practice of Intervention; England and Neutral Trade in the Napoleonic Wars and Now; Paradoxes of Post-War Europe; Democracy and the Control of Foreign Affairs*; and other studies.

JAMES T. SHOTWELL, PH.D., LL.D., is Professor of History at Columbia University, Director of the Division of Economics and History of the Carnegie Endowment for International Peace, a trustee of the Endowment, and General Editor of a monumental international series of volumes on the Economic and Social History of the World War. As chairman of the committee of distinguished Americans who in 1924 proposed for the consideration of the League of Nations a plan of security and disarmament, as the originator, with Professor Chamberlain, of a Draft Treaty which in 1927 had a significant influence upon the project for renunciation of aggressive war, and as the author of a volume on *War as an Instrument of National Policy*, revealing the history and meaning of the Pact of Paris, Professor Shotwell holds a preëminent place among the interpreters of the Kellog-Briand Treaty.

BENJAMIN BRUCE WALLACE, PH.D., special expert for the United States Tariff Commission since 1918 and chief of the division of preferential tariffs and commercial treaties since 1921, has served as a professor at Wooster College, Princeton, Michigan, and Northwestern University, and is now a member of the faculty of the Georgetown School of Foreign Service.

W. RANDOLPH BURGESS, PH.D., served in the World War with the rank of major and was assistant chief, then acting chief, of the statistics branch of the General Staff. After the war he became assistant director of the division of education of the Russell Sage Foundation, while completing his graduate studies for the doctorate at Columbia. Since 1920 he has been with the Federal Reserve Bank of New York as editor

of its *Monthly Review of Credit and Business Conditions*, and since 1923 as Assistant Federal Reserve Agent. His recent volume on *The Reserve Banks and the Money Market* is an important study of the operation of the Reserve System.

WALTER LIPPMANN, formerly an editor of *The New Republic* and now of the *New York World*, served as Assistant to the Secretary of War in 1917, then as secretary of the Inquiry directed by Colonel House to prepare data for the Peace Conference; and subsequently as an officer attached to the General Staff. Among the books which have earned for Mr. Lippmann his enviable reputation as an author, one should mention *A Preface to Politics* (1913), *Drift and Mastery* (1914), *Stakes of Diplomacy* (1915), *Public Opinion* (1922), *The Phantom Public* (1925), and *Men of Destiny* (1927).

JOHN STRACHEY, of the *London Spectator*, is the brilliant son of a distinguished friend of the Academy. As one of the intellectual leaders of the British Labour Movement, Mr. Strachey contributed to the discussion at the morning session a sagacious commentary on the importance of considering the economic realities which underlie the problems of peace.

HON. GEORGE W. WICKERSHAM, LL.B., LL.D., Attorney-General of the United States in the cabinet of President Taft, 1909-1913, has practised law as a member of the firm Strong and Cadwalader from 1887 to 1909 and as a member of Cadwalader, Wickersham and Taft since 1914. He was president of the New York Bar Association from 1914 to 1917 and was elected president of the American Law Institute in 1923. As a member of the international Commission on Progressive Codification of International Law, appointed by the League of Nations in 1924, and as chairman of the Committee on International Justice and Good Will of the Federal Council of Churches in Christ in America, national president of the League of Nations Non-Partisan Association, and chairman of the executive committee of the France-America Society, Mr. Wickersham has been a distinguished and active leader in the movement for international justice and peace.

JOHN H. FAHEY is a prominent banker and publisher. Beginning his newspaper career as a reporter, he eventually be-

came editor and publisher of the *Boston Traveler*, 1903-1910, president and publisher of the *New York Evening Post*, 1923, president of the Clarke Press, and president and publisher of the *Worcester* (Mass.) *Post*. He acted as chairman of the delegation from Chambers of Commerce in the United States visiting Europe in 1911. Subsequently he served as a director and chairman of the executive committee of the Chamber of Commerce of the United States, 1912-1913, and the same national organization made him its president in 1914-1915, honorary vice-president, 1915-1920, member of its senior council, 1921-1923, and chairman of its committee on foreign affairs. He was chairman of the organizing committee of the International Chamber of Commerce and American director for that body from 1921-1926. He is chevalier of the Legion of Honor, commander of the Order of the Crown (Italy), and officer of the Order of the Golden Sheaf (China).

JOSEPH P. CHAMBERLAIN, LL.B., PH.D., Professor of Public Law at Columbia University, is Director of the Legislative Drafting and Research Fund of Columbia, Chairman of the Council of American Learned Societies, Chairman of the Committee on International Relations of the Social Science Research Council, and member of the International Labor Office's Committee on Slavery and Forced Labor. But perhaps even more important are his unofficial functions as an expert incessantly called upon for advice respecting various international problems. He was one of the group who prepared the "American Plan" for security and disarmament which was considered at Geneva in 1924; and in 1927 he collaborated with Professor Shotwell in formulating a widely discussed "Draft Treaty" for the renunciation of aggressive war. Professor Chamberlain is the author of numerous articles and monographs and of a scholarly treatise on the international administration of the Danube and Rhine rivers.

DAVID HUNTER MILLER, a distinguished member of the New York bar, was appointed Special Assistant by the Department of State in June, 1917, shortly after the United States entered the World War, and was a member of the Inquiry which, under the direction of Colonel House, prepared data for the Paris Peace Conference. As legal adviser to the American Commission to Negotiate Peace, Mr. Miller played an import-

ant rôle in the drafting of the peace treaties and in collaboration with Sir Cecil Hurst of the British Foreign Office drew up the final draft of the Covenant of the League of Nations. After the Peace Conference, Mr. Miller continued his work with the State Department as Special Assistant, until October, 1919. In 1921 he served as counsel for the German Government on the Upper Silesian question, before the League of Nations. He was a member of the group which submitted the American plan for security and disarmament to the League of Nations in 1924. His book on *The Geneva Protocol* (1925) and his recent volume on *The Peace Pact of Paris* are penetrating analyses of the problem of international security. Mr. Miller is the author also of *Secret Statutes of the United States* (1918), *Reservations to Treaties* (1918), *International Relations of Labor* (1921), *The Polar Regions and Their Problems* (1927), and numerous articles and monographs.

ALLEN W. DULLES received the degree of A.M. from Princeton in 1916, entered the Diplomatic Service and was appointed Secretary of Legation in the same year, served at Vienna, then at Berne, then at Paris in 1918-1919 with the American Commission to Negotiate Peace. After the Peace Conference he was transferred to Berlin and later to Constantinople, whence he returned in 1922 to serve the State Department for four years as chief of the Division of Near Eastern Affairs. He resigned from the Diplomatic Service in October 1926 to take up the practice of law with the firm of Sullivan and Cromwell, New York. Mr. Dulles was a member of the American Delegation to the Preparatory Disarmament Commission at Geneva in 1926 and legal adviser to the American Delegation at the Three-Power Naval Conference at Geneva in 1927.

STEPHEN P. DUGGAN, PH.D., LL.D., has been Director of the Institute of International Education since 1919 and of the faculty of the College of the City of New York since 1896. He is secretary of the American University Union in Europe; trustee of Vassar College, the Constantinople College for Girls, the American College at Athens, and the World Peace Foundation; and director of the Council on Foreign Relations, the Italy-America Society, the Hungary Society, the Netherlands-America Foundation, etc. Among his published works should be mentioned *The Eastern Question* (1902), *A History of*

Education (1916), and *The League of Nations* (1919). Although, as the program indicates, Dr. Duggan intended to speak at the afternoon session, he was unfortunately called away to attend an important conference.

NORMAN H. DAVIS began his business career in Cuba, shortly after the Spanish-American War, became interested in banking, sugar, and other enterprises, and organized the Trust Company of Cuba, of which he served as president from 1905 to 1917, when he accepted the post of adviser to the Secretary of the Treasury in connection with foreign loans. In 1918 he represented the Treasury in London and Paris; and in 1919 as finance commissioner of the United States to Europe, member of the Armistice Commission, member of the Supreme Economic Council, financial adviser to President Wilson, and member of the Reparations and Financial Commissions at the Paris Peace Conference, he was intimately and responsibly concerned with the important international negotiations which concluded the World War. Returning to Washington, he became Assistant Secretary of the Treasury in charge of Foreign Loans, from November 1919 to June 1920, and Under Secretary of State from June 1920 to March 1921, during part of which period he was Acting Secretary of State. He has also served as Chairman of the Conference on International Communications, as Chairman of the Commission appointed by the League of Nations to determine the status of the disputed territory of Memel, and as a member of the American Delegation to the International Economic Conference at Geneva in 1927.

ARTHUR CAPPER, United States Senator from Kansas since 1919, has been, successively, compositor, reporter, city editor, Washington correspondent, and publisher-proprietor of the *Topeka Daily Capital*, and is also publisher and proprietor of *Capper's Weekly*, *Farmers' Mail and Breeze*, *Household Magazine*, *Capper's Farmer*, *Missouri Ruralist*, *Ohio Farmer*, *Pennsylvania Farmer*, and the *Michigan Farmer*. He is President of the Board of Regents of Kansas Agricultural College, and a director of the Farmers National Bank of Topeka. Before his election to the Senate, Senator Capper served four years as governor of his state. In the Senate he has taken a prominent part in discussions of farm relief and other major

national problems, and as a member of the Senate Committee on Foreign Relations he has been a powerful friend of peace. He was the author of the "Capper Resolution" which is alluded to in several of the papers printed below, and which proposed an international treaty declaring that the contracting governments would not protect their nationals in giving aid and comfort to an aggressor nation.

ROY A. YOUNG began his career as messenger for the First National Bank of Marquette, of which he later became assistant cashier. He was appointed governor of the Federal Reserve Bank of Minneapolis in 1919 and is now Governor of the Federal Reserve Board, which has general supervision over the twelve Reserve Banks. No one could discuss with greater authority and insight the connection between international peace and the conduct of our national financial affairs.

To the distinguished speakers who addressed the meeting and whose contributions give this volume its value, the most sincere gratitude and appreciation are due. The officers of the Academy likewise wish to express their indebtedness to the Committee on Program, whose advice and suggestions were of inestimable value. The membership of the Committee was as follows:

COMMITTEE ON PROGRAM

SAMUEL McCUNE LINDSAY, *Chairman*

MISS ETHEL WARNER, *Executive Secretary*

JOHN G. AGAR	HOWARD L. MCBAIN
FRANK ALTSCHUL	OGDEN L. MILLS
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IVY L. LEE	GEORGE W. WICKERSHAM

PART I

THE RENUNCIATION OF WAR AS AN INSTRUMENT OF NATIONAL POLICY

WORLD PEACE AND ECONOMIC STABILITY¹

EDWIN R. A. SELIGMAN

McVickar Professor of Political Economy, Columbia University

I

IN the present-day discussion of war and peace it has become customary to dilate on the manifest shortcomings of war. In a broader view of the subject and especially with a view to explaining the persistence of war, we should like to reverse this habit and dwell on the advantages or at all events the putative advantages of war. For unless there were some such ostensible benefits, we could scarcely explain the fact that the history of mankind has been to so large an extent the history of war.

It does not suffice to ascribe the persistence of war to the mere brutal or combative instincts of man. Private war—the *bellum omnium contra omnes* of Hobbes—has long since disappeared, not so much because of the policeman as because of the recognition on the part of individuals that private war on the whole does not pay and that it does not conduce to the best interests of even the temporary victor. The fact that war between nations has persisted is due not so much to the absence of an international policeman as to the fact that, until recently at least, certain advantages seemed to be associated with war. What are these advantages?

We shall not attempt to deal here with the political and social aspects of the subject. These would take us too far astray. We need only call attention to the fact that war has sometimes served to rouse nations out of the rut of routine and the slough of lethargy. To those who remember William James' brilliant essay on the moral equivalent for war, this is unnecessary. Nor need we call attention to the influence of war in bringing about political revolution or the often needed centralization of authority. Confining ourselves to the strictly

¹ Address as Presiding Officer at the First Session of the Annual Meeting, November 23, 1928.

economic field, let us advert to some fairly obvious considerations.

It is clear that war has often led to conquest and that, for the victor at least, economic advantages attended the acquisition of territory or the rounding-out of the national domain. Perhaps no nation has availed itself of war for this purpose to the same extent as our own. Not a small part of our continental empire is the result of war. What is true of the United States in its continental empire is true of many other countries past and present in their colonial empires, almost all of which have been won at the point of the sword. While it may perhaps not always be true that trade follows the flag, it is scarcely open to doubt that the acquisition of colonies has in the course of history been sought for the purpose of securing not only the provision of raw materials but also the development of a foreign market. Where the anticipated prize has been so rich, is there any wonder that the efforts should have been so persistent?

Even within the country itself, however, apart from all colonial or foreign relations, there have often been economic advantages resulting from war. In the first place we are only now recognizing one of the most important reasons why war is popular and its continuance endurable. This reason is to be found in the general rise of prices which almost always accompanies war activity. War dislocates the normal equilibrium of production and consumption. It cuts down production because of the presence of the worker at the front; it enlarges consumption because of the stupendous demands of government for supplies and munitions. Apart from this combination of market conditions which in itself suffices to explain the rise of prices, we have the fiscal program of government, and especially of modern government, with its war taxes and its still more elaborate loans, all of which tend, although perhaps in different measure, to engender an inflation of the price level. A period of rising prices, however, while it exerts different influences on various classes of the community, almost always benefits the business man who purchases his materials at one level and sells the finished product at a higher level. While war sometimes leads to a compulsory restriction of individual consumption, we are all primarily producers and

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estimate our prosperity in terms of the surplus of production over consumption. The fortunes which are acquired during the rising price level of a war are often of a permanent kind, especially if the inflation is not followed by an equally sudden and dramatic deflation.

In the second place, the instability created by a war sometimes throws a country upon its own resources and engenders the growth of a national industry which had hitherto been lacking. We need only point to our war of 1812, which laid the foundation for the so-called American system and which initiated the movement of protection. A war not infrequently gives the fillip needed in the transition from an agricultural to an industrial community. Moreover those who are acquainted with the masterly studies of Sombart on war and capitalism need scarcely to be reminded of the part that war has played in a development of the industrial revolution.

If, then, we take a cold-blooded view of history, it is impossible to deny the fact that one of the reasons why war has persisted so long is because of the prizes that it has held out to the victor.

As over against these undoubted but much-neglected considerations it is comparatively trite to descant on the disadvantages of war. Limiting ourselves again to the economic field, which is the subject of our discussion today, it is easy to point out why wars no longer pay in the old sense. It has, however, not always been realized that the explanation of this phenomenon is to be sought in the change in economic conditions. The economic life of a primitive state of civilization makes war, at least to the victor, advantageous: the economic life of a developed state of civilization dissipates these advantages. The two fundamental causes of this change are first, the increasing costliness of war, and, second, the development of a world economy.

As these points are so familiar, we can dismiss them with a mere mention. Modern wars have become so costly because of the progress of science and the control of man over the forces of nature. Instead of the combat of man with man, each armed with a spear and a shield, we have the complicated machinery of modern warfare with the Big Berthas, the Dreadnoughts, the tanks, and the aeroplanes. A day's clash under

modern conditions involves a greater destruction of wealth than a year's fight in former times. The consequence is that a protracted conflict today threatens to consume the whole of the accumulated capital which it has taken generations to amass. The last war brought half of the world to the brink of the abyss: had it lasted a little longer it would have destroyed modern civilization itself. Moreover, this is as true of the victor as of the conquered. We have only to look at the parlous situation of both parties to the great war to realize that their profits, wrung out of the blood and misery of the combatants, weigh but as dust in the balance.

The other reason why war is becoming unprofitable to all concerned is the growing interrelation of the economic life of the world. A wise shopkeeper will not impoverish his customers. The collapse of the foreign market has its repercussion upon the domestic economic life. Every nation, as we now have learned from the Great War, has the roots of its prosperity interlaced with those of its neighbors. Peace nowadays is becoming not only advantageous but imperative to the economic wellbeing of every nation.

II

The second point in our discussion is the relation of peace to modern capitalism. This has hitherto been very inadequately treated. In the fifty thousand years or more which have marked the history of man since he emerged from the savage state, we have gone through only the first stage of civilization. This I should call the stage of inequality. As each small part of the globe has gradually developed and acquired wealth, it has frequently done so at the cost of other and larger sections which have been untouched by the forces of an advancing civilization. Even today there are still huge areas that are in a more or less primitive economic condition. Even in old empires like China and India modern capitalism has not yet attained a secure foothold. It has perhaps never been clearly realized that the industrial revolution has been dependent on the one hand on this inequality of economic conditions and on the other hand on the exploitation of natural resources. What made the machine so profitable in Great Britain was the foreign market for goods and the foreign

market for capital in the undeveloped parts of the world. What is making industrial capitalism profitable in the United States today is the opportunity to devote all the facilities of mass production to the unexampled natural wealth with which a young and potentially rich country like ours has been endowed.

This stage of economic life will not last forever. The time is coming when almost all of the earth's surface will be utilized; when the irresistible growth of capital and of the scientific control of nature will spread to the uttermost parts of the earth; when the transition period will be over, with every nation enjoying its supply of industrial equipment and demanding its share of the raw material which the bounty of nature has perhaps not conferred upon it. In proportion as we approach this period it will be realized that most of the present-day conditions resting upon inequality and compulsion will have disappeared and that every nation will find its prosperity more and more dependent upon its ability to utilize the results of training and education that may give it an advantage in the production of those commodities for which its national genius may be particularly marked. In the degree in which we are slowly reaching that far-off era we shall find the economic consequences of peace to be almost as pronounced in the relations between nations as the economic consequences of peace have been perceptible in the relations between individuals. With the rapidly coming maturity of mankind, with the substitution of the era of international equality for that of inequality which has hitherto marked the slow progress of the world, we may expect to witness in far sharper relief than is discernible at present the effect of peace on economic stability.

III

If then we have, for the time being at least, a condition of peace, and if the projected world compact is to be anything more than a mere gesture, we need to consider carefully the factors which are likely to preserve peace. These two points involve our attitude and our action.

So far as concerns the attitude to peace, it goes without saying that whatever conduces to friendly relations is helpful and

that whatever tends towards suspicion or antagonism is to be deprecated. This leads us to a consideration of certain recent episodes in our political history. It is true that every nation, like every human being, must at bottom believe in itself and cherish the secret conviction that it is superior to its neighbors. Unless a man has such self-confidence he cannot achieve his full measure of success. Unless every nation is able to kindle in its citizens a feeling of intense loyalty and undiluted patriotism, it can accomplish little. But the more cultivated the individual, the more will he be aware of his own deficiencies and the more will he refrain from vaunting his own superiority. Especially if he has been favored by fickle fortune, he will not flaunt his prosperity in the face of the less fortunate. Should not a cultivated nation be as sensitive and as courteous as a cultivated gentleman? It is true that we have become rich and powerful, although the reason is to be found only partly in our own merits and perhaps to a greater extent in our good fortune. But in all the things that go to make up a great civilization, can we claim a like superiority over the rest of the world? Are our science, our art, our music, our manners, our philosophy of life so much in advance of those of our neighbors? Is a nation which has rounded out its territory by conquest and which today spends for military and naval purposes combined more than any of the European countries called upon to lecture its neighbors upon what it considers right and proper?¹ Is a nation which, for reasons however good in its own estimation, has refused to join the rest of the world in the one great forward step that has been taken for the elaboration of a common civilization justified in assuming a holier-than-thou attitude? Is such a point of view calculated to engender feelings and reactions that tend to make for the preservation of the good will which forms the substratum of peace? If we are permeated by the spirit of the peace compact which our Senate is so soon to discuss, would it not be far better to cultivate an attitude of sympathy and friendliness rather than to plant, as we are now in danger of doing, the seeds of suspicion and antagonism?

¹ The figures for the army and navy in 1927 are as follows (in dollars): Germany, 161 millions; Italy, 225 millions; France, 274 millions; Great Britain, 507 millions; the United States, 570 millions.

Even more important than our attitude is our action. Here indeed we see the other side of the problem, not the influence of peace on economic stability, but the influence of economic stability upon peace. It is of course entirely too much, in the present juncture of events, to expect that any nation will subordinate its own clearly defined economic interests to a world ideal, if that world ideal seems to be opposed to its own progress. Protective tariffs, immigration laws, and all the other concomitants of modern economic nationalism still have a long course to run. But if the peace compacts really mean what they say, if the nations of the world intend to forego war as a means of attaining national ends, it is imperative that our action should at all events not be calculated to imperil the continuance of the peace. Is it not possible, especially in the degree in which the world is slowly attaining the stage of economic equality to which I have referred — is it not possible, I will not say to subordinate, but at all events to merge, our individual and separate interests in the common interests of a united community of nations? If the time is past when each country expects to raise itself upon the prostrate form of its neighbor, and to monopolize either the control of raw materials or the disposal of finished products, it is imperative for every nation carefully to consider its stake in the joint welfare. In short, whether world peace will lead to economic stability depends to a great extent upon what we do with it and upon our determination to preserve intact the fragile structure of peace. But the attainment of that objective will not be furthered by smug self-satisfaction, by the rattling of the sword, or by the reading of moral lectures to the rest of the world.

THE HISTORY OF POST-WAR PEACE PROPOSALS BEGINNING WITH THE LEAGUE COVENANT

WILLIAM E. LINGELBACH

Professor of Modern European History, University of Pennsylvania

THE movement to insure peace since the World War is marked by steady progress, by an ever-increasing public interest, especially among business and commercial groups by the constant improvement in the machinery and the plans designed to prevent war and, finally, by the interjection into the treatment of the subject of clear, scientific thinking. The discussions have been brought down out of the clouds and the realm of sentiment into the practical everyday contacts of international business. The dreamers have been joined by the realists and the two are today making common cause. The rationalizing process of the movement is being rapidly achieved. The organization of peace is recognized as a practical and imperative necessity of the New Era of civilization upon which we have entered.

The peace proposals beginning with the League Covenant manifest themselves in several directions. The first and most important is seen in the broad constructive programs for the organization of peace reflected in the establishment of the League of Nations and the Geneva Protocol; the second in the series of treaties, usually bilateral in character, mutually guaranteeing security and the *status quo*. The great number of arbitration treaties, among which our treaty with France is the most recent example, belong in this category. The third appears in the efforts to remove, or lessen, the causes of war by plans for the reduction of armaments and the fair treatment of minorities in the hope of blunting the edge of irredentism; and the fourth is a bold frontal attack on the whole system of aggressive war as a phase of national policy by its renunciation and its outlawry.

The first and last are largely the result of the World War. The others were well known, in principle at least, to the diplomacy of pre-war days, and are intimately associated with the

old concepts of the *status quo* and the balance of power guaranteed by armaments.

The League and the Covenant

The peace proposals in the League Covenant take us back to the first and the last of the Fourteen Points: the demands for "open covenants openly arrived at" and for the creation of a League of Nations. The appointment by the Conference of Paris of the Commission on the League is well known. The Covenant, incorporated as an integral part of the peace treaties, was the result. The primary purpose of the League, as stated in the opening paragraph of the Covenant, is the prevention of war and the preservation of peace, and to these great ideals the member states pledge themselves. The Covenant set up the machinery through which international disputes of a nature likely to defy settlement by ordinary diplomacy might be adjusted; it laid down rules and procedure for such cases; it sought to create confidence and allay suspicion by giving publicity to international engagements and finally, it attempted to establish a sanction or adequate authority in the enforcement of international law. The basis for the organization and perpetuation of peace was laid down, and its further development into a great international system was expected to progress steadily under the auspices of the League of Nations. Unhappily it was too closely linked up with the maintenance of the *status quo* established by the Treaty of Versailles. This applied particularly to article 10. As a consequence the great adventure was started with encumbrances that have greatly retarded its development.

Treaties of Security and Mutual Guarantee

Despite the positive provisions for guarantees and security in the Covenant, however, the statesmen of Europe were disinclined to put entire confidence in them. The memory of the war was still too strong. Fear, coupled with a passionate determination to safeguard the peace and the *status quo* established by the treaties, caused them to attain their ends by the pre-war methods of separate treaties and alliances. An unsuccessful attempt in this direction was the ill-fated tripartite security pact demanded by France, and signed on June 28,

1919, by Wilson, Clemenceau and Lloyd George for their respective governments. As is well known, the pact like the peace treaty was rejected by the United States, and France, failing to obtain the formal guarantees she expected from her two powerful allies, negotiated a series of bilateral treaties with her continental friends. Her example was quickly followed by others.

The first of these treaties was the Franco-Belgian alliance of 1920. According to the notes exchanged between the two governments—thus far the notes and not the text of the treaty have been registered with the League Secretariat—"the object of this understanding is to re-enforce the guarantee of peace and security, resulting from the League of Nations." France has five treaties of this kind; Czechoslovakia, ten; Jugoslavia, six; Rumania, Poland and Italy, each five. Altogether, twenty-six were signed before the Locarno Treaties in 1925. On the surface they purport to create purely defensive alliances but they also constitute a powerful bulwark for the *status quo*. So far as France is concerned, these treaties, especially those with the Little Entente, took the place of the Russian Alliance in a new balance of power. In some ways they were also an effective substitute for the tripartite security pact. The armies of the Little Entente are modern and efficient and their governments are vastly more interested in the maintenance of the *status quo* in Europe than are Great Britain and the United States.

The effort of France at the Conference at Cannes, and again at Genoa in 1922, to bring England into a general agreement of this kind, guaranteeing the *status quo* on the eastern as well as the western front, developed a decided difference of opinion between the two governments. The points of view are brought out clearly in a memorandum by Lord Curzon to the Cabinet in January, 1923. He points out that British public opinion would not endorse any guarantee that went beyond the point of providing British action before a German army actually crossed the French frontier, and that making English action contingent on "what constitutes an act of aggression" before that, would be apt to give rise to "serious and even dangerous disputes." The French draft proposal, as interpreted by the French ambassador, says Lord Curzon, demanded that the Anglo-French agreement should apply in some un-

defined way to the frontiers of Poland and other Eastern European states which are regarded by the French as the outer frontier of their country. While ready to guarantee the frontier between France and Germany, England definitely declined to do so for those in Central Europe. The difficulty between the two powers was finally solved, as we shall see below, in the Locarno Treaties.

In the meantime the question of the compatibility of these bilateral treaties with the Covenant of the League has been raised repeatedly.¹ The case in their favor is based on articles 20 and 21. The latter recognizes the validity under the terms of the Covenant of international engagements such as treaties of arbitration or regional understandings like the Monroe Doctrine for securing the maintenance of peace.

Arbitration Treaties

This brings the work of the League into harmony with the many arbitration treaties. In its Resolution of August 29, 1916, the United States Congress definitely laid down the principle that it is the "policy of the United States to adjust and settle its international disputes through mediation or arbitration, to the end that war may be honorably avoided." The United States alone is a party to 112 arbitration agreements, the last and most important being the revised treaty with France which is to serve as the model for others. Many go back to pre-war days and most of them relate specifically to so-called justiciable cases. We are often criticized for refusing to enter into a general arbitration treaty. It should be remembered that the proposed amendment of article 3, paragraph 2, of the Covenant making arbitration compulsory was rejected by the members of the League themselves.

Arbitration Schemes

Considerable interest also attaches to arbitration schemes. Of these, the best known in this country are the Houghton proposals for a plebiscite in Great Britain and the United States

¹ The discussion always proceeds from article 20 as a basis. There the members of the League "agree that this Covenant is accepted as abrogating all obligations or understandings *inter se* which are inconsistent with the terms thereof, and solemnly undertake that they will not hereafter enter into any engagements inconsistent with the terms thereof."

on a proposed treaty between them providing that all disputes for thirty years be referred to arbitration. It is Mr. Houghton's contention that the two peoples most directly concerned in maintaining peace are Great Britain and the United States, and that much good would result from a plebiscite on the question of submitting all disputes to an arbitral body like the International Court. If the people voted favorably, the duty of the governments to negotiate such a treaty would be clear. Other peoples approving the proposal by similar plebiscites should be entitled to similar treaties. The duty to abide by the decision of the arbitral body or court is implied.

Another scheme is the model Draft Optional Convention for Obligatory Arbitration of Disputes presented by Dr. Nansen to the Third Committee of the League Assembly in 1927. It pledges the signatory states to submit any question that it has not been possible to settle in a reasonable time by the normal methods of diplomacy, either to judicial decision or to decision through the procedure laid down in the articles of the agreement.

The Disarmament Proposals

While these plans to buttress the peace of the world by bilateral treaties, arbitration agreements and regional understandings were being made, the question of disarmament also came in for vigorous discussion. Of first-rate importance in this movement was the Washington Conference of 1921-22, called by President Harding. The United States, the British Empire, France, Italy and Japan took part in the discussions on the reduction or limitation of naval armaments. It soon became apparent that the question of disarmament was closely related to that of security and guarantees, to the position of the powers in China, the Anglo-Japanese alliance, and the balance of power in the Pacific. Other powers took part in this phase of the conference. The results are well known. Limitations were placed on the building of battleships; declarations were signed against poison gas and the use of submarines against merchant ships; a demilitarized naval zone was accepted for the islands of the Pacific; and the Four-Power Pact was signed, in which the United States, Great Britain, France and Japan agreed to respect each other's rights in the Pacific.

They also agreed to take counsel together on the course to be followed in case any other power threatened the *status quo* thus set up. The independence of China and the Open Door were upheld in principle.

The disarmament of Germany and her allies, provided for in the Paris treaties, had as a corollary a certain measure of disarmament for the other powers. The double purpose was clearly explained by the Allies in a note by the French Prime Minister, stating that the object was not alone to prevent Germany from resuming her militarism, but also to make a "first step towards the general reduction and limitation of armaments. . . ." Article 8 of the Covenant declared "that the maintenance of peace requires the reduction of national armaments to the lowest point consistent with national safety. . . ." To this end the duty is laid upon the Council of formulating plans which are then to be submitted to the respective governments for consideration.

To carry out these provisions the Council appointed a Permanent Advisory Commission on Military, Naval and Air Questions in May, 1920. Its membership was, however, made up exclusively of military and naval men. In order to secure a broader and more disinterested approach to the study of the problem, the First Assembly created a Temporary Mixed Commission to which it appointed, in addition to the military experts, civilians trained in international economics and finance. The commissions set to work promptly, but soon found that the nations represented on the Council were not enthusiastic over disarmament. The Assembly, on the other hand, voicing the feelings of the many small states, was naturally in favor of it and pressed for action.

In the spring of 1921 the Mixed Commission made a report which brought out clearly the difficulty of reaching a general plan of disarmament, first, because the United States and Russia could not be included, and, second, because without security against attack, the nations did not feel safe in reducing their armaments. "The Esher plan" to apply to land armaments the Washington plan of set ratios was unacceptable.

After further discussion for a year, however, a plan was submitted to the Assembly in 1922, recommending a reduction of

armaments on the basis of assistance pledged by the signatory powers in case of attack by some powerful adversary. A long and spirited discussion ensued, in which it became clear that only with the removal of fear and a commensurate guarantee of security could a reduction of armaments be expected. By a formal vote, the Assembly embodied the idea in a resolution laying down the important principle that *security and disarmament are inseparable*, and that the latter can be considered only in the light of the former.

From this point on, disarmament is overshadowed by the problem of security. The Preparatory Commission of the League tried hard to reconcile the different national viewpoints, but without success. In the meantime the Three-Power Naval Conference met in Geneva in the summer of 1927. It, too, failed because of the wide difference of opinion between the United States and England in the matter of cruisers. These repeated failures and, above all, the continuance of the great armaments led to protests from Germany, impatient over the Rhineland occupation and military manœuvres in that territory. Russia, too, entered the discussion. In November, 1927, her representative to the Conference, M. Litvinoff, submitted a proposal for complete disarmament. The proposal met with a cool reception and nothing was accomplished. Soon afterward, however, the British and French foreign offices secretly reached an understanding in the Anglo-French Accord of July 30, 1928, the publication of which has had a most unfortunate effect on the whole question of disarmament.

Draft Treaty of Mutual Assistance

When the Assembly accepted the principle of the interdependence of disarmament and security, it referred the further consideration of the question to the Council with the request that it draw up a draft treaty to be submitted to the member states for consideration and comment. This was promptly done, and a discussion ensued which greatly broadened and deepened the study of the problem. On this basis the Mixed Commission undertook to work out a more complete draft.

Two plans, one by Sir Robert Cecil, the other by Colonel Réquin, were combined into the Draft Treaty of Mutual Assist-

ance of 1923. It embodied the essential provisions for a general pact of security and disarmament in their relations to each other. By article 1 aggressive war was declared a crime. In article 2 the signatories agreed to help the power attacked along the lines suggested by the Council of the League. Article 3 sketched a plan for obligatory reduction of armament in proportion to the security afforded by the pact. Ramsay MacDonald, acting for the British Empire, rejected the proposal, as did the north-European powers who disliked so radical a departure from their neutral policy.

A further weakness in the Draft Treaty of Mutual Assistance lay in the fact that it did not define aggression. The statement in article 1 that "the High Contracting Parties solemnly declare that aggressive war is an international crime and severally undertake that no one will be guilty of its commission", was therefore innocuous until a more definite understanding of the meaning of aggressive war could be reached.

The Borah Resolution and the Outlawry of War

An effort to cut the gordian knot by the outlawry of war was introduced into the discussion at this time. In a pamphlet entitled the "Outlawry of War; a Plan to Outlaw War," Mr. Levinson made a direct frontal attack on the whole system of war. The plan calls for a conference of all civilized nations for the creation and codification of international law. Specific provisions are laid down as basic. These are the abolition of the use of war for the settlement of international disputes, declaring war a public crime but reserving the right of defensive war; the abolition of professional soldiery and the adoption of the Swiss system of a citizen soldiery; annual reports by each nation on its military establishments which are to be verified by committees of experts; and, finally, the setting-up of international machinery, especially an international court with all-inclusive jurisdiction, for the adequate administration of the new system. The plan was given more than usual publicity by Senator Borah who introduced it in a Senate resolution and had it printed in the *Congressional Record*.

The proposals met with much popular support in certain quarters in this country and abroad. The slogan "outlawry of war" caught the popular imagination. Senator Capper's

well-known resolution in the United States Senate was in part an outgrowth of the wide-spread discussion which followed. The campaign received further and more official support, however, by the action of the Eighth Assembly of the League in adopting a resolution prohibiting all wars of aggression. To this was added, in the present year, the action of the Sixth Pan-American Conference at Havana banning all "aggression" from the Western Hemisphere.

The Geneva Protocol, a Proposed Amendment to the Covenant

Impressed by the need of an acceptable formula in regard to questions like aggression and sanctions, an American Committee, with Dr. Shotwell as Chairman, drew up a plan for "security and disarmament" providing not only for renunciation of aggressive war, but also for the establishment of a simple test by which the aggressor could be determined.

This plan combined with the Draft Treaty of Mutual Assistance, was taken up by the Fifth Assembly, the most brilliant since the formation of the League. The prime ministers of Great Britain and of France, MacDonald and Herriot, both supported the plan. A resolution endorsing the ideas was adopted, and the appropriate committees, 1 and 3, were instructed to embody them in a formal document for adoption. The result was the well-known Geneva Protocol. This proposed supplement to the Covenant specifically outlaws all aggressive war. Settlement by pacific means is made compulsory. The "aggressor" is defined as the nation that refuses to submit its case to arbitration, to the Permanent Court, or to the Council of the League; or having submitted it, refuses to abide by the decision and resorts to war (art. 10). This definition is of first-rate importance because it effectively disposes of that much-abused pretext of defensive war as a camouflage for aggressive designs. It is clear, and much more definite than the tests of aggression based on provocative policies like mobilization or acts of force.

In case the attacking nation refuses to abide by the award the Protocol sanctions defensive war. In that case other powers which have accepted such obligations under separate agreement may come to the aid of the attacked in what has been aptly called coöperative defense. In this wise, a unique and

somewhat original method of establishing a sanction in the enforcement of international agreements is provided. This is developed more in detail in article 13, where various means and ways for the operation of the sanction are considered. "Economic sanctions" in particular receive a good deal of attention, the framers of the Protocol suggesting a more careful study of this highly modern method of coöperation (article 12).

Additional machinery is provided for the adjudication of disputes and for arbitration, which is made obligatory upon all. Legal cases must be submitted to the Permanent Court of International Justice.

In general the Protocol was designed to amend and give strength to the Covenant by compelling settlement rather than simple conference, and by taking away the right to resort to war left under the Covenant if the Council failed to agree. As is well known, the Protocol, although acceptable to many states, and officially acted upon by the Assembly of the League, did not commend itself to Great Britain and her self-governing Dominions. The obligations were too serious.

The Locarno Treaties

Out of the apparent *impasse* following the failure of the Protocol a new direction was given to the movement for peace by the action of Germany. From 1919 to 1925 Germany had been debarred from the councils of the powers. She had been sentenced like a culprit at the bar of justice, and the definite charge of her guilt was formally set forth in the now famous Article 231. The Rhineland was occupied. A huge and indefinite reparations bill hung like a dark cloud over her financial and economic reconstruction.

A disposition to bring Germany back into the councils of European powers became more and more pronounced in certain quarters, and in 1922 an invitation was extended to both Germany and Russia to send delegations to the Genoa Conference. Unhappily the two powers signed the treaty of Rapallo just at the critical moment, largely destroying the confidence and good will which might otherwise have led to a peace program based on a wider participation of states than previous plans had enjoyed.

Not till the acceptance of the Dawes' Plan in 1924 and the withdrawal of the French and Belgians from the Ruhr, placing the reparations question on a business basis, was confidence sufficiently restored to make any further efforts at *rapprochement* practicable. Then came a specific proposal by Germany to renounce all claims to Alsace-Lorraine, enter the League as a permanent member of the Council, join in a mutual guarantee of the western frontier, and agree not to seek a modification of the eastern frontier by force. The terms proved acceptable, save for the demand for revision of the article on war guilt, which was rejected. German statesmen were invited to a conference at Locarno with representatives of Great Britain, France, Belgium and Italy. The Locarno treaties, seven in all — three dealing with guarantee or security and four with arbitration — were the result.

The most important of these is the Security Pact in regard to Western Europe. It provides for (1) the maintenance of the western frontier of Germany and of the demilitarized zone as fixed by the Treaty of Versailles; (2) an agreement not to resort to war on the western front, except in self-defense or in accord with the demands of the League of Nations; (3) the acceptance of the authority of the Council of the League calling upon the signatory powers to aid in the enforcement of the pact; (4) an agreement to submit to judicial decision or a conciliation commission all disputes not settled by ordinary diplomatic procedure; and (5) mutual guarantees to give aid against any signatory power attacking without having first submitted the case to judicial or other peaceful settlement. For the first time since the signing of the peace treaty the signatures of German statesmen appear side by side with those of the other western powers — Luther and Stresemann for Germany, Vandervelde for Belgium, Briand for France, Chamberlain for Great Britain, and Mussolini for Italy.

The Locarno treaties bind all the signatories to the *status quo* in the West, in what has been aptly called a security pact between all, rather than an alliance against a particular state or group of states. The treaties also mark a very important advance in the direction of securing peace, in that they are a guarantee to Germany as well as a guarantee by Germany. All the signatories are under obligation to maintain the *status*

quo, save in the East where it may be subjected to peaceful revision. Furthermore the treaties provide the means and the method for enforcing the terms of the pact against the aggressor.

The Briand-Kellogg Proposals

Passing over the extraordinary Russian proposal for absolute disarmament in November, 1927, which had the momentary effect of a bomb in international circles, the next important move came from the United States. The immediate occasion for our entry into the campaign for the preservation of peace was afforded by France in connection with the anniversary of our entry into the war. On June 20, 1927, M. Briand submitted the draft of a pact of perpetual friendship between France and the United States. In the first article of the proposed treaty the high contracting parties condemn "recourse to war and renounce it respectively as an instrument of their national policy towards each other." Secretary Kellogg replied on December 28, suggesting in place of the treaty for the renunciation of war between France and the United States alone, a broader agreement signed by "all the principal powers of the world". "It has occurred to me", Secretary Kellogg wrote, "that the two Governments, instead of contenting themselves with a bilateral declaration of the nature suggested by M. Briand, might make a more signal contribution to world peace by joining in an effort to obtain the adherence of all of the principal powers of the world to a declaration renouncing war as an instrument of national policy."

In his reply, transmitted through the French ambassador to Washington, Briand accepted the suggestion but substituted the phrase "war of aggression" for "war as an instrument of national policy". He also raised certain objections to a multilateral pact because of possible difficulty of reconciling the obligations of the proposed pact with those most of the powers were already committed to by the League Covenant, the Locarno Treaties and other international conventions.¹ Secretary Kellogg replied to the effect that if the treaty obligations of France permitted her to propose a bilateral treaty to renounce war with the United States, "it is not unreasonable to suppose that they can be interpreted with equal justice

so as to permit France to join with the United States in offering to conclude an equivalent multilateral treaty with the other principal powers of the world". In short, "a government free to conclude such a bilateral treaty should be no less able to become a party to an identical multilateral treaty since it is hardly to be presumed that members of the League of Nations are in a position to do separately something they cannot do together."

The Pact of Paris

On April 13, the State Department submitted to the other Great Powers a draft of a multilateral treaty along the lines of the negotiations with France. A week later France submitted her draft, incorporating the specific exceptions that seemed to her necessary, especially the obligations of the signatory powers in the application of the sanctions under the Covenant and other treaties.

The replies of the governments to which the notes were addressed were in general favorable to the American viewpoint. The British, however, in giving their adherence, brought out clearly that they considered the interpretations put upon the plan by Secretary Kellogg in his speech before the American Society of International Law on April 28 as of primary importance in interpreting the treaty. This speech, therefore, becomes a sort of annex to the Pact. It answers the question concerning defensive war by declaring self-defense to be an inalienable right. On the question of the application of sanctions the speech pointed out that while no specific obligations

¹ "The American Government cannot be unaware of the fact that the great majority of the powers of the world, and among them most of the principal powers, are making the organization and the strengthening of peace the object of common efforts carried on within the framework of the League of Nations. They are already bound to one another by a Covenant placing them under reciprocal obligations, as well as by agreements such as those signed at Locarno in October, 1925, or by international conventions relative to guaranties of neutrality, all of which engagements impose upon them duties which they cannot contravene. In particular, your excellency knows that all states members of the League of Nations represented at Geneva in the month of September last, adopted, in a joint resolution tending to the condemnation of war, certain principles based on the respect for the reciprocal rights and duties of each."

were imposed, each signatory would be released from the obligations of the treaty as against any power violating its terms.

This point was further stressed by the Canadian Prime Minister, MacKenzie King, who drew attention to the fact that the same problem had arisen under the Covenant of the League. Canada, he said, "has always opposed any interpretation of the Covenant which would involve the application of these sanctions automatically or by the decision of other states". It was on the initiative of Canada that the Fourth Assembly, with a single negative vote, accepted the principle with respect to military sanctions, "that it is for the constitutional authorities of each state to determine in what degree it is bound to assure the execution of the obligations of this article by employment of its military forces."

Sir Austen Chamberlain also drew attention to the fact that there were certain regions in the world whose welfare and integrity were of such vital interest to Great Britain that their protection against attack was to the British Empire a measure of defense. "The Government of the United States," he continued, "have comparable interests any disregard of which by a foreign power they have declared that they would regard as an unfriendly act."

With these explanations, or reservations, as some would call them, the Kellogg multilateral pact renouncing war as an instrument of national policy was formally signed in Paris on August 27, 1928, by the representatives of fifteen states—Germany, the United States, Belgium, France, Great Britain, Canada, Australia, New Zealand, South Africa, the Irish Free State, India, Italy, Japan, Poland, and Czechoslovakia.

It marks a distinct and very important advance in the organization of peace. True, there are those who compare it with the Holy Alliance, that "loud-sounding nothing" of a century ago. They speak of it as a gratuitous gesture involving a moral obligation not to go to war, and, if it suits our interests, to coöperate against an aggressor. Such an interpretation of the Paris Pact fails to take into account the stern realities of the New Era that underlie the movement against war of which the multilateral pact is a logical and evolutionary development.

First, it commits the signatory powers to the important prin-

ciple of the renunciation of war as an instrument of national policy. Second, it brings the United States into full coöperation with the Great Powers of the world for the preservation of peace. After ten years of political aloofness we at last give up the technique of isolation. Third, we accept the definition of "aggression" to which we have not heretofore been committed. Fourth, if we ratify in good faith, and no one would suggest that we do so on any other basis, we must regard the violation by an aggressor state of its treaty with us as a serious matter.

A state having recourse to war, without an attempt at settlement by pacific means, despite its agreement with us and the other signatory powers, could hardly expect to continue to enjoy our friendship. We shall be under more than a moral obligation to deny to the aggressor state the advantages of our benevolent neutrality, even if we do not coöperate in a defensive war against the aggressor. Although the Pact avoids all details as to aggression, and omits those provisions of the Covenant which provide for specific sanctions, it presumes our coöperation in putting down aggressive wars. The extent and the manner of our coöperation is left open for decision along the lines of our constitutional limitations and custom as each individual case arises.

WHAT IS "WAR AS AN INSTRUMENT OF NATIONAL POLICY"?

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AFTER the authoritative survey in the field of economics that our Chairman has given us and the equally authoritative survey of the field of diplomatic history by Professor Lingelbach, I have been chosen as one from an academic world, who is more or less a war casualty, to explore the future and define the undefined, for the topic assigned me is a novelty in the history of international relations, and I venture to say in a field of international law.

The formula used by the treaty, which I prefer to call the Pact of Paris—in order not to leave out any of the signatories or participants in that treaty—"the renunciation of war as an instrument of national policy," is a new formula in the international commitments of the world. It is a formula which cannot be taken apart. It should be hyphenated as one phrase or almost as one word. We do not renounce "war" in the Pact of Paris. We renounce one kind of war only, war as an instrument of national policy, and let me say very emphatically that every single word in that phrase is of vital importance if we are to understand just what the United States and the other powers are proposing to do at this time.

When I turn to the analysis of the phrase, however, I find that not only is this phrase new but the field into which it injects the commitments of modern states is also a field that has never been analyzed in terms of more than the merest externals of international law. I refer to the fact that war itself has never been analyzed in a substantive way. There has never been a history of phenomena of war except in terms of military or naval acts, never an attempt to analyze the kind of thing that war has become in the industrial and financial life of the modern world. That is an appalling situation,

when you think of it: that we are, as I believe we are, at the turning point—a turning point that may take many generations—of one of the greatest reforms, if not the greatest, in all human history, and yet we have never come to grips with the essentials in the evil that it is proposed to get rid of, nor have we yet succeeded in intellectually analyzing instead of emotionally apprehending the phenomena of modern war. The very first word in the phrase tends to elude us the moment we come to analyze the phrase itself, “war as an instrument of national policy.”

I do not propose to take the few minutes I have with you in the happy exercises of academic medievalism by going back into every detail in the attempt to define war itself; but taking it for granted that we know, generally speaking, that this act of force on the part of governments is of a kind differing from the general peaceful relations of states, even if we have not drawn closely the juristic frontiers, let us deal practically instead of academically with the problem before us.

In the course of the negotiations, the Secretary of State, Mr. Kellogg, was called upon to define what he meant by his own proposition. Let me say in passing, although this has nothing to do with the specific subject assigned to me, that Mr. Kellogg's explanations of what he meant have been taken in certain quarters hostile to the treaty as reservations forced upon him contrary to his own meaning. I only hope that I shall never suffer a worse fate in the interpretation of my own ideas than to have my interpretation accepted as a reservation on my ideas. Those are not reservations but the definition and explanation by the United States of what it is attempting to do in the present treaty.

What is the scope of the definition and explanation of war as an instrument of national policy? Mr. Kellogg stated first that it is taken for granted that the inalienable right of self-defense is not touched by this treaty. Therefore, war as an instrument of national policy is not war of self-defense. That is point one.

But this brought out a further unofficial comment, never made in the official documentation, that the category of defense was not defined, and that therefore in defining war by an undefined term, war also has remained undefined. That point

Mr. Kellogg met by a disclaimer, stating that defense could not be defined in general and sweeping terms without opening the door to the chance of nations' misusing the general formula in order to fight wars of national policy under the camouflage or pretext of defense. "No," said Mr. Kellogg, accepting the point raised previously by the British both in connection with the Council meeting in Geneva in 1925 and in the subsequent statement of Sir Austen Chamberlain in the House of Commons, "defense cannot be defined in general terms." So we are apparently left holding both horns of the dilemma, as it were, at the very first stage of the definition.

Then the British added to this another difficulty. They said that there were certain regions in the world, the defense of which constituted a vital interest for the British Empire and that defense in those regions was substantially an act of defense for the British Empire. This so-called British Monroe Doctrine—so-called from an unhappy and inappropriate reference, apparently to our Monroe Doctrine, in Sir Austen Chamberlain's following sentence—was injected as another element of definition of the things reserved, and by contrast a further definition of the thing renounced.

Then there was a third point upon which all the nations answering insisted, that the renunciation of war as an instrument of national policy should not affect in any way the obligations of members of the League of Nations to come to the help of a victim of aggression when the duty was pointed out to them under articles 10 and 16 of the Covenant.

These three reservations, explanations, or what you will, these three points tend to give us some frontier, some confines for the definition of the thing against which the treaty is directed. Let me deal with them very hurriedly. First, Mr. Kellogg in his note containing the speech he made to the American Society of International Law, intimated, I think, that defense was properly understood in the sense of defense of the soil of an invaded territory. If you look at the text of Mr. Kellogg's explanation, I think that is a fair implication, as far as he goes. That very cautious explanation or limitation does not seem to me adequate. I do not mean to say that it is not right; it is perfectly correct, but it does not reach far enough. The categories of defense extend beyond

the action of the defense of an invaded soil. Especially since the airplane has come, this is absolutely clear to anyone who is familiar with the phenomena of war. The only adequate defense against the airplane, speaking realistically and as the wars of the future would be fought, is to attack the airplane before it leaves the ground. There is no adequate defense for an invaded city or land once the airplane with its heavy bombs is above the point of destination.

That is mere incident, however, for the whole treatment of defense must rest upon another distinction than the place where the war is fought. In parenthesis, the claim of Britain to have fought anything like a defensive war in the last war is, of course, in point here, because it fought on the Plain of Flanders and in France. Not *where* a war is fought, but *how* or *under what conditions*, constitutes the category of defense which we shall have to detach from the commitment of this treaty.

When the British said that there are regions of the world, protection of which is vital for the British Empire itself, they were perfectly correct; we should have not the Monroe Doctrine in question here but the defenses of the Panama Canal. The strategy of the sea calls for freedom of the units engaged on the seas so as to permit the engagement to be fought at the point of advantage for the combatant that can choose it. To repeat: it is not where, it is how and under what conditions that constitute the terms of legitimate defense.

There are juristic conditions that can be laid down, to enable us to define the terms of legitimate defense. These can be worked out of the present treaty, fortunately, although Mr. Kellogg, with proper caution against the academic mind, disclaimed the generalities of definition. Nevertheless, we can work out of this treaty the same definition which was refused in general terms. How? Article 2 of the treaty is very important in this regard. Article 2 says that the signatories must solve their disputes in future through pacific means of settlement. The vagueness of that commitment has perhaps misled some people to think that it is not much of a commitment. It is tremendously important in the working of the treaty, because we signed a treaty with France last February, and have others ready with other countries at the present time, designating the pacific means of settlement. If you put our

treaties of arbitration and conciliation together with the present commitment, you have an indication of the alternative for war provided through the working of article 2. We also have arbitration, conciliation and conference already established as precedents in the Havana Conference and in the Four-Power Pact on the Pacific. We have mechanism set up or at least indicated for the carrying out in policy of article 2. And that Power which refuses article 2 of the treaty and its established machinery and implementation in the other parallel treaties, and goes to war instead, is given a warning in the preamble—you must work backwards in this text—as to the sanction which is implied in the treaty itself. The sanction is not a positive one; it is a negative or a neutral one.

In the preamble to the treaty you come upon the statement embodying this negative sanction. Rather than quote it literally in the terms of the treaty, I shall give Mr. Kellogg's explanation of it. Mr. Kellogg, explaining the commitment in the preamble, said that the other signatories are freed from the obligations of the treaty, they recover liberty of action toward any co-signatory which goes to war in violation of it. But going to war in violation of the Pact means violation of article 2 plus the implementation of the other treaties that are now in process of negotiation.

Therefore, you come back to the simple fact that in the provisions for the effective carrying out of this treaty we have, after all, I believe, reached back to the simple little formula set forth in the clear words of Monsieur Herriot, Prime Minister of France, in Geneva in 1924, that that nation henceforth is an aggressor state which goes to war in violation of its commitment to take the case to "arbitration". M. Herriot used this word "arbitration" in the most general sense. In other words, we find in the treaty, after all, in the exception to commitment, a definition: defense is defined with a juristic frontier, not a local or geographic frontier, and that is the sum total of the exception to this treaty. Other war, so far as I can work out the terms of this treaty, is henceforth to be renounced.

In closing, let me say that I think perhaps it was wise upon the part of Mr. Kellogg, as it was natural upon the part of Sir Austen Chamberlain, to refuse the general definition, because

if you were to involve a general definition in the terms of a treaty of this kind, you might perhaps turn the Congress of the United States still further into an academic body! Conceivably no decision might ever be reached. But, assuming the actual working out of this distinction in the way indicated, the treaty nevertheless has made provision for the development of its commitments in the future succeeding policies of the United States.

Finally, there is still a more important point ahead of us, perhaps as important as anything in the whole set-up of the treaty. The treaty does not call for an immediate codification of international law—and let me parenthetically say that nowhere in the official documentation except in a side remark is the word “outlawry” ever used. A call for codification of international law at the present time to set this new series of ideas clearly before us, would, I think, be a great mistake. What is needed is not further definition of the agreement in the treaty, but a readiness to take on the understanding reached in the present treaty and to accept for it the pertinent implementation by a further and more whole-hearted coöperation with those instruments of international justice already at work—the World Court, the Court of Arbitration and the League of Nations. The advisory opinions of the World Court are all-important in this regard. Let me say that we shall have reason to reverse our whole opinion on the question of advisory opinions in the coming ten years if I am not very much mistaken. A further definite coöperation with these instruments already in existence, following a dynamic process instead of a set, formal and finally arranged series of conditions, is the only solution for the effective carrying out of a reform that passes into an untried area of human experience and must be adjustable to each new set of conditions, not tied to the hampering scholasticism of the past. It must be adjusted to the responsibilities of actual facts in a world situation whose outlines are only dimly appearing before us. That is, I take it, sound policy.

THE EFFECT OF THE ABOLITION OF WAR UPON NATIONAL COMMERCIAL POLICIES

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IT has been said that prophecy is the most gratuitous form of error. Any errors of prophecy or opinion which I express today are, of course, my own and can not be attributed to any of my colleagues or superiors, but the gratuitousness of the errors, I call you to note, must rest on the consciences of the Program Committee.

War strains every source of revenue, piles up debts, unbalances budgets, and depreciates currencies; war disorganizes industry, overstimulating some lines and crippling others; war foments national feeling, hatred of the foreigner, and the demand for self-sufficiency. These immediate effects of war have further effects in commercial policies.

The demand for revenue during the American Civil War led to the establishment of high import duties, imposed for revenue but later maintained for protective purposes. The demand for revenue during the World War prevented the abolition of the duty on sugar. The demand for revenue led Canada to impose surtaxes which increased the preference accorded to British products and the discrimination against American products. The demand for revenue was one of the reasons alleged by the British War Cabinet in 1915 for the imposition of duties upon automobiles, musical instruments, clocks and watches—the first protective duties in two generations. It has been also the reason officially alleged for the maintenance of these so-called McKenna duties. An incidental evil of obtaining revenue from import duties is the hypocrisy it engenders in those politicians who are unwilling to admit their protectionist policy.

The unbalanced budgets of Europe, their depreciated currencies and the adverse balances of trade which accompanied these other disturbances, called forth after the late war a host of commercial restrictions, amounting in Germany and Poland

to general prohibitions upon all imports except as licensed,¹ and to restrictions upon exports almost as extensive. From Italy to Norway and from Portugal to Estonia luxuries were burdened with sales taxes and import duties, if not prohibitions, in vain attempts, by cutting off millions in imports, to offset currency inflations reckoned in billions.

War depresses some industries and leads to feverish expansion in others. In 1919 the Government of India imposed a protective export duty upon untanned hides and skins, alleging that the tanning of *hides* had been stimulated by the war and the Government must nurture this war-baby; and that the tanning of *skins* had been prohibited during the war and was now entitled to special encouragement to revive it. The European beet-sugar industry dates from the English blockade during the Napoleonic wars. The protective policy in this country attained its first vigor in 1816 to protect the industries which had arisen or expanded to supply goods which had earlier come from Europe in times of peace.

War stimulates nationalism and the idea of self-sufficiency. Great Britain's second departure from her long-established free-trade policy was the protection of synthetic organic dye-stuffs and intermediates; her third was the protection afforded to "key" industries by the "Safeguarding of Industries Act." In millions of tiny latch needles Germany had held the keys to the British knitting mills. These and many other keys the British determined to hold in their own hands thereafter, particularly the keys to military defense. One of the major economic results of the war is the stimulus which it has given to the chemical industries of Great Britain, France, Italy, the United States and Japan; and the larger part of this change is due to the protective duties and prohibitions enforced since the war. During the war most strenuous efforts were made to improvise supplies of the essential dyes and other chemicals, but after the war most of this trade would have reverted to Germany except for the change of policy in Great Britain and the extension of policy in the other countries, due to the conviction that dependence on outside sources for chemicals was dangerous. For some time in the United States, until recently

¹ Much sympathy has been wasted because the treaty of peace imposed brief restrictions upon Germany's freedom to raise her import duties.

in France, and still in Great Britain and Japan, this protection took or takes the extreme form of prohibition of imports except as licensed.

Further illustrations might be given in other fields—for instance, shipping. It was the war which put the United States Government into the shipping business, where it still is. But we need not multiply instances. It will not be denied that wars and expectations of wars have had immense influence upon national commercial policies in the past. Our subject today, however, is not “How far may present commercial policies be attributed to past wars?”, but “How far would the abolition of war operate to change existing national commercial policies?”

The abolition of war would obviously remove a stimulus to the building up of artificial barriers of many kinds. The tendency of the abolition of war would presumably be in the direction of lower and less numerous barriers to international trade; it would lead logically to fewer and less rigid policies of state control.¹ Can we measure the strength of this tendency? There is many a slip between a tendency and a result. Some of the most common of political fallacies arise from jumping from tendency to effect. A logical, nay inevitable, tendency is observed, and without further examination it is assumed that it will run unchecked to the logically apparent result.

When the Tariff Act of 1922 was in the making, some predicted that the increase of rates would sharply diminish our imports, would equally diminish our exports, and would have a very unfavorable effect upon our exporting industries. The tendency is undeniable. The result simply did not happen. The prophets had jumped from the tendency to the result with-

¹ H. Wickham Steed wrote recently: “In Europe tariff barriers are likely to be lowered or removed in proportion as the protection of special industries for eventual conversion to war purposes is seen to be needless; and political frontiers may cease to have greater significance than English county borders or the divisions between the states of the American Union have today. The federation of Europe may become a reality.

“These are imaginable results of the war. They are not yet positive, and the current of events may seem, at times, to run away from them. Yet, looking ahead at the end of the first decade of non-war, they seem to me to be not only possibilities but certainties of the future.”—“Ten Years After the Armistice,” *Current History*, November, 1928.

out any statistical examination of the amount of increases of duty, the kinds of articles affected and the probable effect upon each kind of article.

Similarly, because the United States has been making great loans and investments abroad, and because the tendency of such loans in the long run is to return in goods, it has been predicted that at no distant date the United States will undergo severe depression because of the quantity of incoming goods. Again, the tendency seems undeniable, the predicted result incredible. The prediction was never, I believe, based upon any statistical study. It seems now not even certain that the tendency will result in a so-called unfavorable balance of trade for the United States, and it was assuredly a tremendous leap from the tendency of loans to return as goods to the conclusion that a country which has normally over four billions of imports would be suddenly submerged by a ruinous flood of merchandise.

If war had been abolished a century ago, presumably protective tariffs would have been less general and lower today. If chemistry had not proved so important in the last war, protective restrictions on chemicals would not be so drastic today. That is what we conceded. But to believe that the elimination of war and the fear of war in the immediate future would reverse the process and would eliminate the tariffs to which war has so powerfully contributed, would be, in my opinion, completely to misjudge the forces at work.

My prediction is that the abolition of war of and by itself will not merely not eliminate restrictive commercial policies but that it will have little, if any, effect upon them. I am driven to that conclusion on two general grounds. The first is the nature of protective tariffs. A critic has said of the flexible tariff provision of the present law of the United States: "It works like an elbow, it flexes in only one direction." In that statement I think he hit upon a characteristic of all commercial policies of a nationalistic and restrictive nature, with the exception of such *bona fide* revenue duties as do not afford even incidental protection.¹

Protective tariffs and other commercial policies recognize or

¹ Suggest the lowering of a so-called revenue duty and the opposition, if any, excited by the proposal will show whether it is a protective duty.

create vested interests. It is often the line of least resistance for governments to increase the tariff rates, for they are always in need of revenue, but they encounter great resistance when they attempt to lower them. If on the morrow of the abolition of war the political leaders of the world should agree that free trade should forthwith be introduced, it would be politically and economically impossible to carry out the resolution, by treaty or otherwise. The ostensible reductions of tariffs by bilateral agreements, very common in Europe, are almost wholly illusory. The rates which are reduced are not the protective rates but those which have been raised for the purpose of bargaining, and it is seldom that the net results are rates lower than would have been put into effect under such a system as we have in the United States where the tariff includes only genuine rates.

If other forces are leading toward a reduction of tariffs, as was the case in Europe in the middle of the last century, bilateral agreements may be used to further that general movement; but from 1878 to the present time there has been, on the whole, a constant progression in the rates of protective tariffs while this system of bargaining and "reducing" the tariffs by treaties has been going on all the time. This is no doubt a one-line sketch, but I have no time to elaborate.

To repeat, protective tariffs and other commercial restrictions recognize or create vested interests. The one unarguable reason for a protective tariff is that it exists. No man is so rash as to suggest the sweeping away of a well-developed protective tariff with great industries dependent upon it. It simply can not be done. Free trade is only a bogey man, constantly exhibited to make the public shrink in horror from the skeptics who question the verbal inspiration of existing tariff rates. If protectionism had established the growing of bananas, coffee and rubber in American greenhouses, it would be next to impossible to lower the rates materially. In fact, it is the moderate, reasonable, and wise rates which have fulfilled their purpose and have become superfluous through the success of the industries which they have established which have been and may be repealed.

The abolition of war might lead to a gradual abatement of the sentiment of nationality. It would not change the general

belief in the economic merits of protective tariffs, nor diminish the claims of the vested interests. There is no reason to suppose that the abolition of war would have any but the most remote and indirect effect upon the protective tariffs already established in the world.

Again we may consider *bona fide* revenue duties which have no protective effect either because of the absence of similar domestic products, or because similar domestic products are subject to excise taxes equivalent to the import duties. Heavy duties are levied in Europe upon coffee, tea, cocoa, mineral oils and other articles not producible in the countries which impose the duties. The assumption frequently made that revenue duties are negligible as barriers to trade is quite unfounded. European countries collect immense sums from such imports only by imposing rates which diminish consumption materially, though they avoid "killing the goose". Will the abolition of war reduce these duties—perhaps the only form of commercial restriction not sustained by vested interests?

Past wars are present in great debts and pension charges. The fear of future wars is present in great military and naval expenditures. The elimination of war would not cancel the debts and pensions. Probably confidence that war has been abolished will be established only slowly and only slowly will expenditures for armament cease. Such a gradual decrease in one item of expenditure is seldom reflected in a decrease of taxation; except in demobilizing after a war, governments almost never decrease their total budgets. And even if the abolition of war meant lower taxes, direct rather than indirect taxes would probably be lessened. I do not deny the possibility that there may be eventually some reduction of revenue duties, for instance, under a Labor or Liberal Government in Great Britain; but the abolition of war is not likely to bring any special prosperity to the countries which export the products subject to the revenue duties of Europe.

The second ground for believing that the abolition of war will not change commercial policy is that the influence of war on commercial policy has been exaggerated. It is easy enough to pick out striking instances where wars have led to drastic commercial policies of one kind or another. The influence of the war, however, was usually working in the direction of the

general current at the time. It was a supplemental force which seemed to be more striking than it really was. The Crimean War, for instance, was unable to stem the free-trade tide in Great Britain.

This exaggeration of the effect of wars may be shown by three points. The first, which I do not wish to stress, is the historical one. If you survey the century from 1815 to 1914, you see a tendency to decrease tariffs which reaches a climax, if I may choose dates somewhat to suit my argument, between 1848 and 1878, with free trade in Great Britain and some approach to it in a large part of Europe. Precisely in those years, from 1848 to 1878, were concentrated all the European wars of that century. Beginning with 1878, in a period of peace, though admittedly an armed peace, tariffs have been rising regularly. Practically every revision of every tariff has been upward. Either war has less effect than has been commonly supposed, or there is a very considerable lag in its effect, which in itself shows that the effect is not dominating. But history is not proof; even with time to elaborate, the point could scarcely be made conclusive.

The second point is that, whatever their origin, the tariffs of today, as one looks them over, do not appear to be directed primarily to the subject of national defense. In the American tariff act many, if not most, of the highest rates are on articles that are totally unessential—laces, veils, braid and trimmings, artificial flowers and fruits, embroideries, gloves, silks, oriental carpets, straw hats, brierwood pipes, dolls and other toys, Christmas-tree decorations, decorated chinaware, metal vanity cases, mesh bags, beaded bags, jewelry, perfumes and cosmetics. I do not overlook the fact that braid is a necessary part of an officer's uniform, and that toy soldiers inculcate military spirit, but I can not convince myself that Congress imposed on each of the articles mentioned, and others equally unessential, rates of from 55 to 90 per cent ad valorem in order to make the country efficient for self-defense. Nor was it the aim of Congress to support these unessential industries in order to convert them into essential industries in time of war.

The tariffs of the other chief protective countries illustrate the same point. It is not for military preparedness that Canada maintains substantial duties upon most manufactured

products. Military considerations are rarely, if ever, mentioned in discussing fiscal policy north of the border. Some may say that this is because war has long since been virtually abolished so far as the United States and Canada are concerned. Quite so. But after the free-trade era in the middle of the last century, Canada was the first after the United States to adopt a protective tariff, and while the party which has been in power has reduced the rates several times since the war, Canada pursues a protectionist policy, and there is no reason to believe that a further abolition of war would change that policy. Cuba and Jamaica and even smaller countries are pursuing protectionist policies within the limits of their capacity without thinking twice of military self-sufficiency. They wish to develop local production of articles which they consume, and the local manufacture of their own raw materials so far as they can, but the object is economic and not military.

The last point to show that the effect of war upon commercial policy has been exaggerated is that the arguments presented to the public, the beliefs of the public, in connection with the subject lay so little stress on war. With today's subject in mind, I gave attention to the last political campaign. If in all the tariff discussion there was a single reference to military self-sufficiency, it escaped me. The arguments in support of the protective tariff were repetitions and variations of old slogans—the (economic) defense of the home market, the employment of labor, the American standard of living, the maintenance of prosperity, and so forth. You will search almost in vain for references to military defense in current discussions.

This point, also, holds almost equally well for a great number of other countries, even though the military argument is somewhat more important in Europe.

Without time to take up various aspects of commercial policy—bargaining tariffs, colonial tariffs, and immigration—we may turn briefly to export duties and export restrictions, which exhibit marked differences from import duties. Export duties on raw materials may have much the same effect as import duties on finished products, but their most striking illustrations are quite different. Canada's restrictions on the export of pulp wood and wood pulp, for instance—in contrast to the

American import duties on paper—are not intended to build up an industry to supply the domestic market, but to build up an industry to supply a foreign market which can not supply itself, especially if deprived of foreign raw materials. The object of such a policy, as expressed by a committee appointed by the League of Nations, is to put the foreign industry in a position of “permanent inferiority”. The desire to stimulate a non-essential industry, which already exports three-quarters of its total product, and to make it increasingly dependent upon outside markets, is obviously not dictated by military considerations—unless it be a vital military achievement to curtail the newspaper space available for the enemy’s propaganda.

There is no reason to believe that the elimination of war would eliminate the desire to exploit other forms of monopolies and quasi-monopolies of raw materials. The desire to raise the price of rubber, potash, nitrates, sisal, camphor, or coffee may possibly be influenced by past wars, but it would be hard to connect this desire with future wars. The controls exercised in time of war may have contributed to the technique and may have familiarized the public with the idea; the war debts have also salved the consciences of some who would otherwise have questioned the equity, e.g., of British exactions from American consumers of rubber. But these controls and manipulations are more directly connected with difficulties arising from unbalanced demand and supply, and there seems adequate ground for believing that the desire for gain would accomplish the same result, no matter how thoroughly the producers might believe there would be no more wars. In fact, if freed from the idea that inequitable exactions might excite possible enemies or alienate possible allies, the exactions and attempted exactions might prove to be greater rather than less.

The “spirit of Locarno” has been praised as bringing peace nearer—commercial as well as military peace. The “spirit of Locarno” has presided over certain international commercial agreements both between governments and between groups of manufacturers or producers in different countries. Some expect these international industrial understandings to promote peace, and for peace to promote the formation of these international cartels. Whether assured peace would or could increase the rapidity with which cartels have recently

been forming is doubtful. But if the abolition of war should promote the formation of international cartels, to that extent our statement that the abolition of war would tend to diminish trade barriers is incorrect. For these international cartels normally begin by agreeing that the industry in each country shall supply the home market, that is to say, in effect they substitute for the existing tariff rates, whether high, moderate, or low, a system of absolute trade prohibitions.

Finally, commercial policy deals with shipping. Of the various phases we are considering, a country's policy in regard to shipping is most closely connected with its offensive and defensive power. Encouragement of national shipping, by subsidies, loans, reservation of the coasting trade and the colonial trade, and by government fleets, together with legislative regulations that certain percentages of the officers and of the crews shall be nationals, is intended to build up auxiliary fleets for time of war. It would seem logical that in this field of national commercial policy would be found the most immediate and greatest effects of the abolition of war.

But here too it would be a gross error to assume that national shipping policies are supported only by the desire to be fore-armed. Herbert Hoover, in his address at Boston on October 15, 1928, said, to be sure, that a merchant marine under the American flag is "essential to our defense". He gave defense just one sentence. Before it and after it he said: "A merchant marine under the American flag is essential to our foreign trade," and "There is only one protection of our commerce from discrimination and combinations in rates which would impose onerous charges upon us in the transportation of our goods to foreign markets—that is, a merchant marine under the control of our citizens."

The Shipping Board has used the misleading simile that a nation without ships is like a merchant dependent upon a competitor for his delivery service. In addition to these beliefs in the economic advantages of national shipping, ships have always stirred the national imagination. There is a thrill in great fleets, in seeing the flag in every port, which makes an appeal similar to the vision of great territories, of "painting the map red". We can only conclude that, even in that phase of commercial policy in which the defense element seems to

play the most direct part, it is by no means certain that nationalistic policies would be dropped if statesmen and people were convinced that war was no more.

I reach the conclusion that if this generation or the next or the one following sees any great reduction of trade barriers, it will not be because in the meantime war has been abolished. Tariffs throughout the world have been rising on the whole for the last half century; whether we have reached the crest of this wave it is impossible to say.¹ Probably many countries whose industrial development has reached no very advanced stage will continue to impose and to increase whatever duties they find necessary to encourage the industries which they desire to develop. The elimination of war by and of itself will have only negative and indirect effects. For instance, it will make the manufacture of potential war materials appear no more desirable than other industries employing like amounts of labor and capital. The abolition of war will no doubt conduce to an attitude and spirit favorable to the elimination of trade barriers. This does not mean that the abolition of war will directly work a change of attitude, but rather that the same movement of opinion, the same forces which are at work in Europe to eliminate war are also exerting influences against trade barriers, and success in one field will allow them to contest the other with the prestige of victory. Foreign relations and the international aspects of commercial policies play much

¹ Some observers believe that influences already at work—including the example of the great free-trade area within the United States, the necessities of mass production, reactions from the difficulties created by new boundaries and new barriers—are about to lead Europe, at least, into a period of reduction and elimination of restrictions upon trade. They are in part misled by the belief that the commercial treaties between European countries represent net reductions of duties below what they would have been had the rates not first been "marked up" for bargaining purposes. They probably do not sufficiently emphasize the fact that protected industries have been growing for ten years within the new boundaries and have become vested interests. Perhaps the efforts toward an economic federation of Europe will not be wholly fruitless—my license as prophet does not cover that field. But if there are sufficient forces to carry through such a movement, it can be done only by destroying the faith of the peoples in the economic merits of protective tariffs; and if that transformation be brought about, the movement may be successful in respect of all but the most essential industries whether war be abolished or not.

more important parts in European life and thought than they do in other continents. The United States, Brazil, South Africa and Australia adjust their policies, in comparison, almost uninfluenced by other than local issues. But both in jostling Europe and *a fortiori* in the more isolated countries, the one essential condition of the abandonment of restrictive commercial policies is a change in the convictions of the people that these policies are an economic success, that they reduce unemployment, raise wages, enhance profits, and bring prosperity. The abolition of war will give peoples more leisure which might be used to think about commercial policies, it may bring about in time a less hostile emotional reaction against the foreigner and his products, but it will not disprove the belief, now become hereditary and well-nigh universal, that the way for a country to become rich is to exclude imports.

EFFECTS OF THE ABOLITION OF WAR UPON NATIONAL BANKING POLICIES

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WHEN we turn from national commercial policies to national banking policies, we find a marked contrast with Professor Wallace's findings,¹ for I think it may be said that in respect of national banking policies we cannot exaggerate the influence of war. The banks of issue of a number of countries were established largely to meet war demands for credit. In the current operations of banks of issue, dealings in government securities, representing largely war debts, assume large importance. For example, a large proportion of the loans and of the open market operations of the Federal Reserve System, are based either directly or indirectly on government securities arising from wars. If we turn to the gold reserves which are held by the banking systems of the world, we find there again that the possibility of war has been a major influence in determining the quantity of such reserves, for to a certain degree they represent a war chest, set aside against the possibility of war as well as against the possibility of lesser demands.

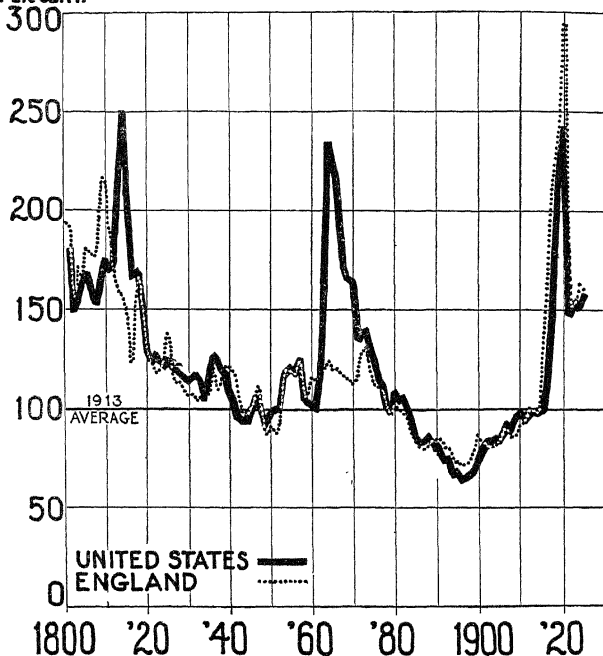
More important, however, than these details of operation, is the fact that the fundamental economic environment in which national banking policy is determined has been almost dominated by war changes. One could illustrate that statement from many different fields, but I shall illustrate it simply by the movements of wholesale commodity prices. The experiences of 1920 and 1921 in this country and in Europe have brought home to men's minds the evils that follow price instability; and the result has been much public discussion of proposed cures for that malady. The usual argument on the subject begins with the hardships which have been brought to humanity by the disasters of 1921, and then proceeds to suggest cures.

¹ Cf. *supra*, pp. 31 *et seq.*

Those are of various characters. Changing the weight of gold in the dollar was one of the early suggestions by Professor Irving Fisher. A more recent suggestion is that the Reserve System should be charged with the duty of stabilizing prices.

WHOLESALE PRICES U.S. and ENGLAND

PER CENT.



In this whole problem of price stability there is one distinction which is not commonly made but which seems to me to be the essence of the problem. This distinction is illustrated by the accompanying chart, which shows the movement of wholesale prices in the United States and in England over a

period of a century and a quarter. The solid line shows the figures for the United States and the dotted line shows the movement of prices in England. The two lines move very closely together. You will note that the chief movements of prices occurred, first, early in the century, at the time of the Napoleonic Wars; second, in connection with our own Civil War; and third, in connection with the World War. If one were to take a sharp knife and cut off those war-time peaks, the resulting line would be relatively stable. I do not wish to overemphasize this point. Even if the war peaks were cut off, there would still be a problem of price stability, but the problem would be much reduced, for the large fluctuations in commodity prices were due almost wholly to war causes.

The story of why prices go up in war-time is familiar to everybody, and has been set forth in all of the economic textbooks. For one reason or another, it is impossible in war-time to tax a people sufficiently to pay for the war wholly out of taxation. It is not true that one generation passes on to another the cost of the war; each generation pays the cost of its own war in capital destroyed, in lives lost. In the process it does bring about a readjustment of indebtedness and national obligations which is called passing the war on to the next generation. It has never been found possible to finance a war wholly out of taxation. The nearest approaches to self-financed wars were the Napoleonic wars which partly paid for themselves by plunder, but that was hardly a case of financing a war wholly through taxation. Since ministers of finance have not discovered a means of financing a modern war by taxation, war expenditures are met in large part by borrowing from the people or from other nations. The immediate result of that borrowing is an inflation of credit and, as a consequence, an inflation of prices.

Perhaps some future finance minister may have the courage, and perhaps some nation may have the patriotism, to finance a war wholly out of taxation. I doubt it very much. But the history of the past shows that the great movements of wholesale prices have resulted from credit inflation, which in turn has resulted from wars. These movements have determined banking policy after as well as during war. Even the banking policy of today has to be determined in relation to trends which

began with the gigantic war-time upheaval of wholesale prices, the readjustment of which may not as yet have fully occurred.

In all discussion of price stability, it seems to me most important to distinguish between methods designed to deal with war-time instability of prices and methods designed to deal with peace-time stability. Much of the thinking on this problem has been quite fallacious, for it has illustrated the evils by pointing to price instability arising from war and has suggested a cure which would operate only in peace-time. The only cure I know of for these major upheavals of prices is either to abolish war or to find a way of financing war wholly through taxation, so that credit inflation does not follow and price inflation does not result. These facts considerations as to inflation may be considered typical of the changes in the economic structure which might result from the abolition of war.

Let me turn to another side of the picture, which must be presented in all fairness. While wars have had their fearful results in the instability of prices and in the profound human suffering which results from price instability, wars have also resulted in certain economic reforms, and there is question whether those reforms can be achieved by other methods than war. Let me illustrate again, by another chart.

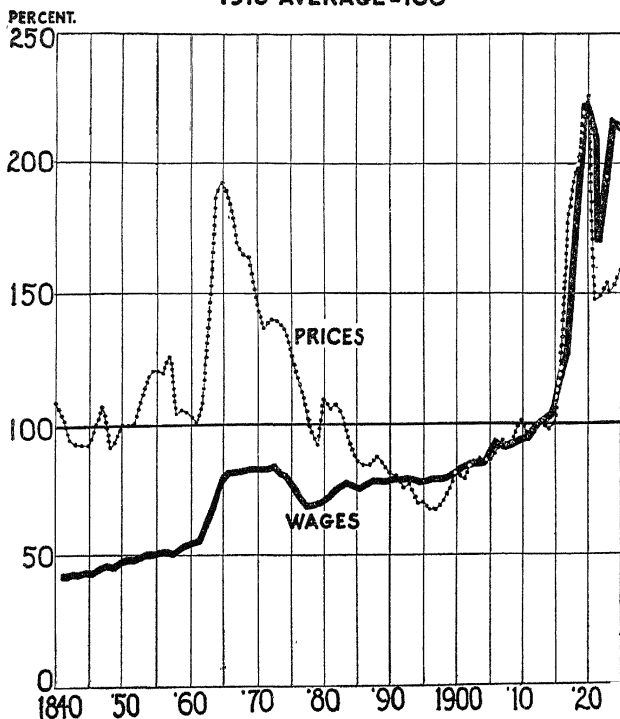
The dotted line on the chart is the price index. From the year 1840 to the Civil War it was relatively stable. At the Civil War period, prices rose rapidly, then they declined almost steadily until 1896, then again they rose gradually until 1914. Then they shot up in the great World War.

The black line, representing the wages of unskilled labor, in the form of index numbers, rose gradually between 1840 and 1860, and then as war prices rose, war wages followed. They did not rise as much as prices, but they followed gradually. Wages always lag behind prices, and it is by the lag of wages behind prices that the people pay, in part, for wars. But wages did not go down when prices went down; they stayed for ten years on a fairly high level. They then receded a bit, but were shortly restored again to the war-time level.

The net result was that the wage line, having started far below the price line, eventually crossed it, moving up. That is to say, the real wages of the population were increased 25 or 30 per cent as a consequence of the war and post-war readjust-

PRICES & WAGES

1913 AVERAGE = 100



ments. The same thing happened at the time of the World War. At first the price line went up rapidly; the wage line followed. Then the price line came down, and the wage line stayed up. Wages have the habit of behaving in this curious way. Once you get wages at a high level, they tend to stay there. I do not know fully why this is true. I suspect it is because, once a man has worked for ten dollars a day, that sum becomes fixed in his mind as a basic wage and he puts forth all his energy to maintain his wage at that rate.

What has been the consequence in the economics of the past few years? Prices went down; and wages stayed up. The manufacturer, finding himself between the upper and the nether millstone, went to work and discovered means of increasing efficiency by which he could pay these higher wages; and we have had, in the past few years, a second industrial revolution, due, to my mind, in no small measure to this displacement of wages and prices which took place as a consequence of the price and wage changes of the war.

Many important banking reforms had their origin in war. One of Napoleon's early acts was to establish the Bank of France as a necessary support for his campaigns. Similarly, the Bank of England owes its origin to the war requirements of William III. In this country the Second Bank of the United States was in considerable measure a war product. The National Banking System was a direct outgrowth of the Civil War. While the Federal Reserve Act passed Congress before the outbreak of the World War, the Reserve System owes its present strength and prestige in no small measure to the circumstance of its war service and the financial upheaval resulting from the war.

In his essay upon "The Moral Equivalent of War," William James indicates that many of the manly virtues are stimulated by war experiences, and from the point of view of the psychologist, he suggests the necessity for finding a moral substitute for war. If war is abolished we may require a substitute to ensure the progress of human institutions. The inertia of humanity is so great that all too often only the stress of war emergency has given us the courage and energy to break down old traditions and reorganize our social and economic structure. Hand in hand with the proposals for the abolition of war should go a recognition of the necessity for liberalism in the remodeling of social and economic institutions.

PUBLIC OPINION AND THE RENUNCIATION OF WAR

WALTER LIPPMANN

IT is my special task to discuss the Pact of Paris in relation to public opinion. There is, of course, no phrase in the vocabulary of politics about which all of us think we know so much and actually know so little as public opinion. I shall not, however, attempt here to deal with the subtle difficulties of defining public opinion. I shall assume that what we mean to discuss is how far and in what way the Pact of Paris may serve to align the mass of people in the signatory states on the side of that settlement and solution by pacific means of all disputes or conflicts of whatever nature or of whatever origin, which is promised in Article II of the Treaty. The discussion, since it deals with matters more or less in the realm of prophecy, naturally involves many incalculable elements. But for the sake of the argument, I shall make what may perhaps be a somewhat large assumption, namely that the treaty will be ratified by all the signatory powers without reservations which in any way emasculate it.

It seems to me that we can make the discussion somewhat more precise if we recognize at the outset how different is the setting of this treaty in Europe and in the United States. In Europe the Pact of Paris is one of a series of treaties all of which aim at the abolition of war, several of which set up international machinery for the settlement of disputes, several of which contain more or less binding obligations to enforce peace. In the United States the treaty is not associated with these institutions for the prevention of war. Except for the American arbitration treaties and the so-called Bryan treaties, the United States is dissociated from the world's coöperative effort to organize peace. The history of the drafting of this treaty indicates clearly, I think, that this difference of background represents certainly a difference of emphasis between Europe and the United States and perhaps even a difference in intention.

I call your attention to the fact that the treaty as originally proposed by Mr. Kellogg contained all that it now contains except one clause which was inserted in the preamble on the insistence of the European powers who are members of the League of Nations. That clause is the one which states that any signatory power which shall hereafter seek to promote its national interests by resort to war will be denied the benefits of this treaty. The insertion of this clause represents the conviction of the European peoples that the maintenance of peace involves not merely the renunciation of war as a national policy, but an agreement to suppress war as a matter of international obligation. The treaty as originally proposed by Mr. Kellogg was essentially a public avowal by each nation that it would inhibit its own impulse to make war. The treaty as finally signed supplements this inhibition with an avowal that most of the signatories believe not merely in the renunciation by each nation of its own belligerent impulses, but in a collective effort to police those nations which fail to restrain their own belligerent impulses.

I have dwelt at some length upon this point because it seems to me that in estimating the effects of this treaty on public opinion it is necessary to recognize that Europe and the United States see the Pact of Paris in different perspectives. If I understand the matter correctly, opinion in Europe will hold that this treaty reinforces somewhat more solemnly the obligations already existing under the Covenant of the League and the Locarno treaties. It will therefore hold that the test of whether this treaty has been violated or not is the test of whether the Covenant and the Locarno treaties have been violated. With respect to Europe, I cannot see that this treaty in any significant way alters either the legal premise or the psychological premises which existed before it was signed.

But with respect to European opinion towards the United States, this treaty does, I believe, make a considerable difference. It alters the expectation of Europe as to what the United States will do in the event of a breach of the Covenant or of the Locarno treaties. I have no doubt that European opinion will hold that since a breach of the Covenant or of Locarno is also a breach of the Pact of Paris, the United

States, as one of the parties injured by a breach of its own treaty, will be in honor bound in some respect to modify its traditional policy of neutrality toward the offending power. It seems to me self-evident that European opinion would never understand our taking the position that a breach of this treaty is no concern of ours and that the treaty-breaking power is entitled to the same neutral privileges at our hands as if it had fulfilled its obligations under this treaty. I believe, in fact, that the President and his Secretary of State could not have agreed to this treaty unless they understood that this is what it implies to Europe. I am deeply convinced that this treaty should be ratified and that failure to ratify it would be a humiliation, but in ratifying it we are bound to recognize that in European eyes it alters radically the implications of American neutrality in any future war.

This brings us to the question of the relation of the treaty to public opinion in this country, and I am compelled, as a requirement of candor to deal at once with the most difficult aspect of it. The United States has maintained for over a hundred years a policy in this hemisphere which in the last analysis rests upon our determination to resort to war as a matter of national policy in order to uphold it. Elihu Root in 1914 as President of the American Society of International Law said:

The Monroe Doctrine depends upon the right of every sovereign state to protect itself by preventing a condition of affairs in which it will be too late to protect itself. Of course, each state must judge for itself when a threatened act will make such a situation. If any state objects to a threatened act and the reasonableness of the objection is not assented to, the efficacy of the objection will depend upon the power behind it.

It has been authoritatively stated time and time again that the Monroe Doctrine was announced upon the responsibility of the United States, can be defined only by the United States, and will be maintained by the United States through its own sovereign power. Fortunately for us and for the world, no case has arisen for over thirty years in which this policy could be effectively challenged and there is no likelihood that any case will arise for many years to come. Nevertheless, no good

end can be served by concealing the fact that the signature of this treaty binds us to seek some other sanction than our own war-making power for the ends aimed at in the Monroe Doctrine.

There are, no doubt, many other urgent reasons why, within a reasonable future, it will be necessary to convert the Monroe Doctrine from a unilateral assertion of sovereign power in this hemisphere into a coöperative international policy. But the signature of the Pact of Paris should hasten the process. For it transforms what was otherwise a matter of expediency and policy into a moral and legal obligation. The Monroe Doctrine in its present form is, in my opinion, inconsistent with this treaty. And while nations do not practice, and perhaps do not need to practice perfect consistency, it is nevertheless a fact, I believe, that sooner or later we shall be compelled to internationalize the Monroe Doctrine or abandon the moral pretension, contained in this treaty.

Therefore my conclusion is that until the Pact of Paris and the Monroe Doctrine have been brought into consistent alignment with each other, and until we have clarified our own intentions toward a treaty-breaking power in some other part of the world, the Pact of Paris will provide no clear standard to which American opinion can rally in the cause of peace. In all the important concrete cases which one can imagine the effectiveness of the treaty is enormously reduced because of these two major obscurities.

In a larger sense, of course, and there are many people who like to discuss these matters only in the largest sense, this treaty adds an important imponderable influence to those individuals and parties in all nations who, by instinct and temperament and interest, are opposed to war. To a certain degree—how great a degree no man I think can foresee until many doubtful points have been clarified—this treaty does tend to make pacifism more respectable and less easy to stigmatize as unpatriotic. The peace party in any country which has signed this treaty may be able in time of crises to maintain that in opposing war it is not only serving the cause of peace, but upholding a treaty to which the nation is solemnly pledged. That may have some weight. That may give courage and self-assurance to many who would otherwise hesitate to oppose

a war. But we should not over-estimate the value of such things. In time of international crisis the situation invariably presents itself to every nation as a threat to its very existence. Where that threat seems ominous enough the war party will prevail in the absence of international institutions which have sufficient authority and sufficient force to prevent the outbreak of hostilities and to hold violence in check while reason asserts itself.

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DISCUSSION

MR. JOHN STRACHEY (of *The Spectator*, London) : I take it that the object of your Program Committee in asking me to say a few words here this morning, was to have me express the viewpoint of an Englishman, and more especially of a member of the British Labor Party. In general, the British Labor Party would approach the question of the possibility of the renunciation of war as an instrument of national policy from an essentially economic angle. We should feel that this subject was inextricably intertwined with the economic structure and the economic realities of the world today. Therefore, it is certainly a pleasure to a member of the Labor Party to find to what a large extent you do connect this problem of peace with the world of economic realities.

You have heard addresses by several distinguished economists and a distinguished banker, and they have dealt carefully and fully with the economic relations which this question so immediately raises. Your first speaker, who spoke from an economic angle, raised the question of the tariffs. He considered the possible effect of the abolition of war upon the abolition of tariffs. We should perhaps approach the subject from the opposite side. We should ask how the existence of tariffs affected the possibility of abolishing war as an instrument of national policy. We, I dare say, should be rather disposed to feel that so long as tariffs, not in themselves but as an expression of that economic nationalism of which they are one symptom, exist, the possibility of abolishing war as an instrument of national policy remains a little remote. I was surprised here the other day in conversation with one of your principal economists—not an economist stationed in some far-off university, either, but an economist in the very heart of your most important economic organ, in the very heart of your banking system—who expressed the view, that it made not the slightest difference to the American economic system whether you had a tariff or not. That was certainly startling, because we in England are accustomed to hearing that you regard your tariff as the cornerstone of the economic system ;

but this great economist assured me that he considered that banking policy today had an infinitely greater reaction upon and control of the economic system. Certainly that view astonished me and I should imagine it is not generally held, but I simply quote it as an example of what economic experts may sometimes be found to be thinking, and as an indication that, after all, the question of tariffs may not be such a dangerous obstacle to the cause of peace as it may seem at first sight.

We view the world economic situation, especially in regard to Anglo-American relations, with considerable alarm. America is just entering, or perhaps has entered, a phase which will naturally lead her to great economic expansion all over the world. We are disposed to think that in order to keep up your level of prosperity, in order to keep up that black line of wage levels which you have been shown by a distinguished banker today, you will have to go out into the world, you will have to send your presidents-elect and your presidents touring many parts of the world, and you will have to enter a period of intense economic expansion.

We feel that in that expansion lies, not indeed the inevitable, but the extreme danger of great political friction. We would ask you to bring the peace pact into relation with economic problems and the economic rivalries. As examples of the sort of thing we have in mind, I will take two situations in which the restrictive policy is on the side of Great Britain. As you know, it is in practice forbidden for any American citizen to obtain an oil lease or even to prospect for oil anywhere within the confines of the British Empire. Or again, most of the rubber supply of the world, as you know, comes from the British Empire, and the British Government has regulated and restricted the output of rubber in the past, and may do so again in the future. These are merely two, and perhaps not particularly striking examples that come to mind when we talk about economic reality. Other larger problems which I need not mention will suggest themselves all too readily—debts, reparations, and other controversies. Never lose sight of those realities, those hard facts which have to be faced when you are studying and when you are endorsing, as we all hope you will, the Kellogg Pact.

That is why I felt Mr. Lippmann's address today was of

such value. He asked you to see what a lot the Kellogg Pact meant if it meant anything at all. He demonstrated that it implies an enormous change and a very real renunciation if it is going to be applied to the world as it really is.

If I perform my function, such as it is, of giving you the line of thought of the Labor Party in England, I should add that the most valuable function which a scientific and educational body such as this could undertake would be the clearing up of these great issues of peace and war, bringing them down from academic and abstract heights and applying them in the real world, facing the real difficulties, showing how and where the real dangers lie, confronting boldly the actual or potential causes of rivalry between great countries like Great Britain and the United States. If you do that, then the discussion and the study of such questions as this can be of the utmost service to the cause of the peace of the world.

CHAIRMAN LINDSAY: We have about fifteen or twenty minutes left, and the topic of the morning and the papers of the morning are open for discussion from the floor.

MR. ROBERT BADENHOP (200 Broadway, New York): The prevention of future wars is not such a hopeless task as many people think. Governments have spent billions to prepare for war, but the nations of the world have never seriously tried to prepare for peace. I welcome the efforts now being made in that direction, such as arbitration treaties and the proposed Kellogg Pact to abandon war as an instrument of national policy. No pact, however, is worth the paper it is written on unless backed by an enlightened public opinion.

Twenty-six years ago in the city of Hamburg, where I was born, I happened to be the secretary of a French debating society. In a discussion on how to preserve peace, I said, "Gentlemen, if you want peace in the world, you must first of all make up your mind that you yourselves want to be honest." I meant Germany then, but what I said for Germany applies to every country in the world.

Strong nations cannot continue, on some pretext or other, to invade weaker nations and take all or part of their land.

One difficulty is the falsification of history in the text books. If you read the history books in the different countries in the world, you will find that the blame for war is nearly always put on the other country. This is a mistake. How can you imagine that we can have peace if we always think the other fellow is in the wrong and we are always right? There should be an international commission to set up a world history text book.

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PART II

NEW USES FOR THE MACHINERY FOR THE SETTLEMENT OF INTERNATIONAL DISPUTES

of disputes is the avoidance of disputes. Once we have committed ourselves to a definite renunciation of war as an instrument of national policy, and to a specific agreement that we will not seek the solution of difficulties except by pacific means, the question will arise, how we are going to avoid getting into disputes so serious in their nature that they must be submitted to some sort of international machinery for adjustment.

Mr. Kellogg in his address before the Council on Foreign Relations last spring made a statement which I would challenge. He said that only justiciable disputes were suitable for submission to arbitration. The experience of the world, especially the experience of the last ten years, is at variance with that assertion. Many disputes have been submitted to arbitration which are hardly justiciable in their nature. Indeed the optional provision in the Statute of the Permanent Court which gives the Court compulsory jurisdiction over all those nations that elect to accept that jurisdiction necessarily implies that there may be disputes not justiciable in their nature which yet may be submitted to the Permanent Court and be decided by the ordinary principles of equity and fairness. But back of the solution of disputes lies the question of machinery to promote better relations between governments, to smooth out possible differences, to eliminate the misunderstandings that result in controversy, to facilitate a candid interchange of viewpoints respecting questions of common concern, and, by avoiding misunderstandings, to remove the possibility of getting into disputes of such nature that they must be submitted to a third party for adjustment.

The paramount importance of the League of Nations lies in the fact that it furnishes a common meeting point of the representatives of nations, where the freest interchange of expression is permitted. Through that free interchange of views and expressions and ambitions and policies, comes better understanding and the avoidance of controversy. In some way, whether by association with the League of Nations or by membership in the League of Nations, if this treaty is to be carried out satisfactorily and to accomplish its principal purposes, our government must come into contact with such periodical meetings with the representatives of other nations, under conditions which make it not only proper but the right of the representatives of

those nations to discuss questions which are of common concern. Out of such association will come that sort of general mutual understanding which goes so far as to prevent differences from becoming controversies. I do not know whether any of the speakers this afternoon will touch on that subject or not, but at all events it is one of the implications of this peace treaty.

A little while ago I was downtown at luncheon with a group of men, among whom was a former ambassador of the United States, a very well-known man, who, speaking of this peace pact, said, "It amounts to nothing." One hears that same expression not infrequently. It seems to me that meetings like this, and like one I attended in Chicago a week ago, where the treaty is discussed and analyzed and understood, are most valuable in dispelling the idea that this treaty has no significance. It is, in my opinion, the most far-reaching agreement that the United States has ever been called upon to enter into. I can imagine nothing more far-reaching than a definite, formal and solemn renunciation of war, coupled with the affirmative agreement not to attempt the solution of difficulties or controversies which may arise with other nations by any but peaceful means. If the American people do not understand that, they ought not to ratify this treaty; if they do understand it and do ratify the treaty, they should understand that the United States is committed to a new policy.

We must put war away from our thought; we must regard peace as the national policy of the United States; and we must bend all our efforts, individual and collective and governmental, to carrying out this most solemn pledge not to resort to any but peaceful methods in the solution of differences which may arise with other nations; we must comprehend the full significance of that undertaking. I believe we do accept it in that spirit. It would be an eternal disgrace to our country if it entered into this treaty in any other way than solemnly and sincerely and in the fear of God.

THE PACT AND WORLD POLITICS

PARKER THOMAS MOON

Associate Professor of International Relations, Columbia University

THE subject of world politics involves so much latitude that considerable longitude would doubtless be required for any adequate discussion of it, but mindful of the plenitude of expert discussion which is in store for you later this afternoon, I shall mercifully restrict my remarks to two or three of the points which seem to me of most importance.

As a preliminary, we should underline the word "world". To assume, as some do, that there is a marked distinction, a water-tight compartment, between European politics and American politics, between European diplomacy and American or Asiatic diplomacy, betrays, I think, rather superficial understanding of the realities of world affairs. If there is one thing which the publication of formerly secret pre-war archives of the Great Powers have demonstrated, it is that so-called European diplomacy before the war was concerned, perhaps more than with any other subject, with the destinies of Africa and Asia and the islands of the seas. European diplomacy was, and is, world diplomacy, world politics in a very strict sense of the term.

As for American foreign policy, one has but to suggest our expanding investments, amounting now to about \$16,000,000,000, scattered through every land in the world; our naval interests which involve the strategic equilibrium on all of the seven seas, if there are seven; our plantations in Liberia, in Brazil, in the Dutch East Indies; our struggle for raw materials which come from all quarters of the globe, to realize that American diplomacy stretches far beyond the borders of this country. Our foreign policy, too, is essentially a matter of world politics.

It is true, and extremely important, that in certain departments of world politics it has been found possible to secure international coöperation through international conferences, through international legislative treaties or conventions, and

through the establishment of international administrative bureaus and organizations. In a recent article in the *American Journal of International Law*, Professor Manley Hudson, of Harvard, gave a list of over 200 multilateral legislative treaties representing the development of this kind of international coöperation before the war, and 166 such treaties in the nine years from 1919 to 1927. Especially striking is the marked increase in the tempo of the development of international coöperation. That list is extremely instructive. I dare say you will forgive me if I refrain from reading the list now, but I commend it to your attention as evidence of the inconspicuous but significant development of a technique which affords even an historian a pretty sound basis for the prophecy that international coöperation is destined to increase to an extent which most of us today can hardly foresee.

It is a very interesting point that when international questions are submitted to this technique of international conferences, international treaties and international administration, problems often lose their dangerous and explosive nature. They become more susceptible of solution, once the solution is no longer thought of in terms of threat, of conflict and of war. Just one outstanding example—the Dawes Plan, removing the question of reparations to a large extent from the realm of ultimatums and threats, of military occupation of the Ruhr, of impossible demands. Once the reparations question was put on the basis of peaceable economic discussion in international conference, the major step was taken toward a solution of that very complicated question.

Moreover, it is also worth pointing out that once you use that technique of international coöperation, results may be achieved which would be quite beyond the reach of single-handed effort. The financial reconstruction of Austria or of Hungary would have been impossible for any single power to accomplish. Only by this new and growing technique can such results be achieved.

I think perhaps it might be pertinent to add that since 1920 this new technique has been, not quite but almost wholly, identified with the League of Nations and the International Labour Organization. Despite the momentous importance of the services of the League in preserving peace at the present

time, future historians will doubtless record that the major function of the League of Nations was to develop this technique of international coöperation.

Yet, in all candor it must be admitted that two major questions have seemed to defy the procedure of international coöperation. First, irredentism, and second, imperialism.

I use the latter word—"imperialism"—with some trepidation. It seems to have been expurgated from the dictionaries used in Washington, except as it may be applied to European nations. A number of very highly placed people in this country seem to feel that imperialism is what we are innocent of. Euphemists may substitute some less downright and more dulcet term. The facts, however, call them by what name you will, remain unchanged in their significance.

One fact is that imperialism has been probably the most prolific source of wars and rumors of wars in the last half-century. You have but to turn over the publications of formerly secret documents to discover how important and how dangerous it was in pre-war diplomacy. It bred almost innumerable minor wars of conquest, wars so frequent, so chronic that often they were omitted from history textbooks and hardly noticed by the newspapers. It bred, too, some major wars like the Boer War, the Russo-Japanese War, and the Tripolitan War—and it was one of the causes of the World War.

Yet, to my mind, even graver than the matter of those wars which actually occurred was the fact that this imperialistic rivalry, the rivalry of nations too eager to share the white man's burden, was responsible for a constant apprehension of war. If fear is a major cause of war, and I believe it is, imperialism has been a major cause of fear of war. Perhaps I had better illustrate that fact. In order to solve questions of rivalry, imperialistic nations have relied, to a degree which the public at the time could hardly have suspected, upon the threat of war. The threat of war was the last argument of bankrupt diplomacy. If you could not obtain success for your national policy of expansion by any other means, you resorted to the threat of force.

For example, Sir Edward Grey, who surely must have known whereof he spoke, declared that when the interests of Great Britain touched those of France and of Russia in many

parts of the world, an "atmosphere of ill-will" was generated, and such an atmosphere is always dangerous. "The blackest suspicion thrives in it like noxious growths under dark skies in murky air."

Sometimes threats of war, producing perilous crises, were evoked by questions which seemed tragically disproportionate to the gravity of war. For example, over a district known as Nikki, which perhaps some of you would have difficulty locating on the map, Great Britain and France came very close to war in 1898. The foreign minister of France confessed that "the maintenance of peace locally depends upon the calmness and discretion of subordinate officers, and even non-commissioned officers, and that it is highly improbable that this situation can endure much longer without a collision, which would almost inevitably precipitate a war, for objects which in themselves cannot be worth so grave a calamity."

The threat of war has been used even to obtain business contracts, e.g. railway contracts in China. Mr. Balfour on one occasion instructed the British Minister at Peking to inform the Chinese Government that unless China awarded to Great Britain certain contracts for railway construction, "we shall regard their breach of faith concerning the Peking-Hankow Railroad as an act of deliberate hostility against this country and shall act accordingly."

We are all of us familiar with some of the more serious crises like that at Fashoda when the French Foreign Minister informed Great Britain that "all France would resent such an insult to the national honour as is involved in the proposal to recall M. Marchand" from Fashoda. "He could not think that it is wished in England to go to war over such a question, but France would, however unwilling, accept war rather than submit." France did submit rather than go to war. It was only a threat, it was only a bluff, but it was a threat which brought Great Britain and France very near to a great war.

From the same cloth Lloyd George cut his famous Mansion House speech of 1911, in which he spoke of the desire of England to preserve peace, but in which he addressed the threat to Germany that if Great Britain's interests were set aside in Morocco, "peace at that price would be a humiliation intolerable for a great country like ours to endure". It was this kind

of threat which brought on the great war in 1914, the threat of diplomacy to use war to enforce national policies.

It is hardly necessary to add that that habit of using the threat of war has persisted since the Great War, despite the profound popular reaction against war. Indeed, imperialism has been exacerbated since 1919 by a number of factors such as the expansive colonial aspirations of a Fascist government in an overpopulated Italy, the struggle for raw materials, the damming up of emigration, the entry of the United States into the world arena in a more active way than ever before. With our very extensive foreign investments, the doctrine which is being proclaimed by our leaders that wherever our investors or their dollars go, the United States Navy will follow to protect them, is of far-reaching import. That doctrine, if pursued to its logical conclusions, will involve us in imperialistic world politics to an extent which I hesitate to imagine.

The other factor I had in mind was irredentism. A detailed discussion would be inappropriate here, but perhaps the dismal admission may be permitted that the problem of irredentism — the problem of "sore spots" such as the South Tyrol, the Danzig Corridor and eastern frontier of Germany, the Saar Basin, Macedonia, Tacna-Arica, Manchuria — still remains very grave; nor has the technique of international coöperation made very much progress toward solving that problem. Redrawing the map of Europe in 1919 created new sore spots in the process of curing old ones. The minorities treaties are good so far as they go, but that is not far. Indeed, is any solution possible as long as irredentist minorities and nations eager to extend their frontiers preserve the hope and the expectation of revising the map by means of war? Until you eliminate the expectation of war, irredentism is an almost insoluble problem, but once you eliminate the expectation of war, irredentism becomes a minority problem which ought not to be impossible of solution.

Similarly with imperialism, the renunciation of war might have an effect upon the causes of war.

The Pact, to be sure, would allow intervention in Nicaragua or in China or in other impotent countries as long as we call it "intervention," or "interposition," or by some other equally innocuous term. If you call intervention "war," of course it

would be outlawed by the Pact because it would be war for the prosecution of national policy. We may admit, then, that the Pact will not solve the problem of imperialistic intervention, nor will it solve the problem of the relations between the backward nations and the dominant powers.

On the other hand, if the Kellogg Pact means anything, it does mean that the statesmen of imperialistic countries will no longer be free to threaten war in case their policies are opposed by other powers. Threats such as those I have quoted will be ruled out by this Pact, in exactly the measure that the Pact is taken seriously. Moreover, the Pact will rule out all openly declared wars of conquest. If you can eliminate those two dangers, you have gone a very considerable distance toward a solution of the problem which has imperiled peace for the last half-century.

In this connection let me reinforce the remark I have already made, that in truly astonishing fashion, when you eliminate the expectation of war, problems sometimes clear themselves up. Great Britain and France had been at swords' points in half a dozen quarters of the world, if there can be half a dozen quarters, for a generation or more, and then in 1903-1904, when the French and British foreign offices discarded their expectation of a Franco-British war, they found it possible in the space of a few months to clear up problems which had been vexing them for generations. They found it possible to reconcile their difficulties in a statesmanlike way. In the light of this and similar episodes of *Realpolitik*, one need not appear wholly unsophisticated when one ventures the guess that if we could remove the expectation of war as a means of advancing imperialistic policies, we might find very much to our surprise that some of the problems now confronting us could be handled with unexpected ease.

Whether the Pact has such an effect or not depends chiefly upon whether it is taken seriously by public opinion. Not being a lawyer, I am not so much impressed by the legal validity of the terms of the Pact. I believe its political value, its moral value, will be very much greater and will indeed be incalculable if public opinion rallies about the principle of the renunciation of war as an instrument of national policy. Whether we are permitted to do that depends primarily upon

the Senate of the United States, but the responsibility is shared by the President and the Secretary of State and by public opinion throughout the country. If this Pact should be rejected, a very grave responsibility would rest upon us as its chief sponsors. Or if, through a new revival of international antagonism and naval rivalry, the imprint of insincerity should be placed upon the Pact, at the very outset, it might then become a mere gesture.

If the Pact is to be such a meaningless gesture, it were far better for the honor of the United States and for the peace of the world that the paper had never been signed; but if the Pact is taken seriously as a great, a solemn and historic decision, this generation may break through the vicious circle of threat, fear, and war. Is it altogether unreasonable to hope that we may succeed in the greatest historic achievement of modern times, the substitution of intelligence for high explosives as the method of solving the problems of world politics?

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THE PACT AND BUSINESS

JOHN H. FAHEY

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THERE is no class which has a greater interest than the business men in the prevention of war, the reduction of armaments, and the settlement of disputes by peaceful methods. Obviously, therefore, business men—and when I say “business men” I mean that term to include bankers—all over the world endorse heartily the Paris Treaty, and are anxious to see its principles recognized and carried into effect.

The business men of the United States, through their organizations, have not yet had an opportunity to take specific action with reference to the Treaty. There can be no doubt, however, concerning their position, for this agreement is in every way consistent with the demands which American business men and those of other countries have been making for years.

One of the trustees of the Academy of Political Science, Mr. Thomas W. Lamont, recently expressed the attitude of business men generally with reference to the peace problem very clearly. Mr. Lamont was prevailed upon this summer to accept the chairmanship of the American Committee of the International Chamber of Commerce, succeeding Mr. Owen D. Young. In taking up this task, he said, referring to present-day international conditions:

At this moment it may not be inappropriate for business men in both America and Europe to give greater thought even than in the past to the view that their policies, their processes and their understandings in international operations can be a distinct factor in the success of that campaign now being waged by the leading statesmen of Europe and America for the establishment of conditions to prevent a recurrence of war. I refuse to believe that men of affairs on either side of the water are so deeply engaged in operations for their own account as to lack conception of the importance which their own relationships and policies

bear upon the question of world peace. On the contrary, through the active and understanding part which they have played in post-war reconstruction, they have clearly shown their conviction that if, in coming generations, this earth is to be made a more stable place to live in, the coming of such an era will depend almost entirely upon the conscious coöperation of men throughout the world.

This statement reflects and summarizes the attitude of business men on this problem for years. The Chamber of Commerce of the United States, the most comprehensive organization of business men in the world, and representative of every class of American business, ever since its organization in 1912 has consistently declared its support of every step looking toward international coöperation, suppression of war, and the settlement of disputes of every character by pacific methods.

In 1915 the National Chamber, acting on the report of a representative special committee, in a nation-wide referendum among its members, by overwhelming votes, made the following declarations:

That the United States should take the initiative in joining with other nations in an agreement to bring concerted economic pressure to bear upon any nation or nations which resort to military measures without submitting their differences to an international court or a council of conciliation and without awaiting the decision of the court or the recommendations of the council as circumstances make the more appropriate.

That the United States should take the initiative in joining with other nations in establishing an international court.

That for consideration of questions between nations, and which do not depend upon established rules or upon facts which can be determined by an international court, the United States should take the initiative in joining with other nations in establishing a council of conciliation.

That the United States should take the initiative in establishing the principle of frequent international conferences at expressly stated intervals for the progressive amendment of international law.

In 1922, in 1923, and consistently since then, the Chamber of Commerce of the United States, without a dissenting vote, has agitated for American adherence to the World Court.

You will note that thirteen years ago the business men of this country declared that our Government "should take the initiative" in endeavoring to secure agreement among the nations to shut off from all access to supplies any nation or nations resorting to military measures without first submitting

their differences to arbitration. I think it is worth remembering that at the time the business men of this country definitely voted for that policy the demand upon the commercial resources of this country, because of the war in Europe, was very great, and the influence of war demand and war profits was apparent in almost every direction. This incident of itself is, I believe, the best answer that can be given to the suggestion, occasionally made in ignorance, that business men are not really interested in the prevention of war. The business men of this country not only have declared that they have no interest in war profits and do not wish to be in the position of making money out of war, but, more than that, they believe that one of the most effective methods of preventing war is the threat of complete economic isolation for the country which provokes war and is unwilling to submit its cause to open and impartial consideration.

In my opinion, the conviction has grown steadily among thoughtful business men since the world conflict that economic pressure is one of the most effective methods of preventing war.

Of course there is every reason for the attitude of persistent hostility on the part of business to war or anything that makes for war. As I have already said, there is likewise every reason for enthusiastic support by business men of a great forward-looking proposal such as that represented by the Paris Treaty for the renunciation of war as an instrument of national policy.

There is no greater menace to the successful conduct of business than war. The processes of business, to be successful, must be constructive. War, on the other hand, represents the maximum of possible destruction. Every well-informed person to-day knows that under modern conditions it is impossible for a sizeable war to develop anywhere in the world without disturbing the commerce and finance of every first-class commercial nation. Moreover, we realize today that any important war practically makes neutrality impossible. The last war proved that the traditional rights of commerce and trade on the high seas have disappeared.

Practically every article known to trade is now regarded as possible war material, and called "contraband." War has become a struggle in which all the forces of the nations must be engaged. Its interference with the conduct of constructive business is so obvious as to call for no argument.

To the practical-minded business man the idea of war as a means of settling controversies has always appeared indefensible. In common with all other classes, the business man first of all abhors war because of the terrible sacrifices of human life which it involves, the great injustices which it imposes and the hatreds which it engenders. As an institution of national policy, considered simply in its economic aspects, the business man regards war as gross stupidity.

What did so-called civilization do for a century before 1914? In effect, it took perhaps half of the savings of the people of the world to employ them through the channels of business in the development of constructive enterprise. It used these savings to develop natural resources, to build railroads and steamships, to open up new sections of the world, to combat poverty and disease, promote education and culture and advance the general happiness and welfare of mankind.

At the same time it took the other half of the world's savings to create the most ingenious machines of destruction which the human mind could devise, and to train millions of men to tear down the constructive things which the race was struggling to build up. Is it possible to conceive of a more nonsensical scheme of things, quite aside from any consideration of its moral or social aspects?

So far as I know there are no accurate figures indicating what the world as a whole has squandered on war and the preparations for war in the last century. The United States, fortunately, has not been afflicted by the war fever as have the countries of Europe, and yet we know that the cost of past wars and the cost of military preparation in the United States has been, and continues to be, enormous. In two annual reports, Secretary of the Treasury Mellon has pointed out that 80 per cent of the federal taxes which are collected today in the United States are disbursed in payment of past wars and in preparation for possible future hostilities. If this is the fact concerning the United States—and it is, since the figures available prove it—it is easy to see what proportion of the results of men's labor in the European countries and elsewhere has been wasted in the prosecution of war which merely invited preparation for more war.

It does not take very much imagination to understand what

a boon to humanity the elimination of war would be. The possibilities which would accrue from employment for constructive purposes of the human forces now organized in military establishments are enormous. The world-wide progress which would result if the great sums which are now thrown away were devoted to constructive effort and the promotion of human welfare are almost beyond calculation. It is for these reasons that the business men of the United States, and other countries as well, are so enthusiastically in favor of every measure which leads toward the establishment of firm peace and the substitution of arbitration for the employment of military force.

Business men have warrant for their faith in the value of arbitration. They have not only been using its processes for the settlement of important domestic business controversies for more than a century, but during the last fifteen years they have found it practical to extend the operation of their arbitration machinery to the international field. The contributions toward peace which are now being made in this direction are not unimportant in establishing better understandings and removing causes of international friction. In 1916 the business men of the United States signed the first agreement between business men of this country and those of South American nations for the arbitration of disputes between themselves. These experiments proved so satisfactory that the system has been adapted to international use generally, and the International Chamber of Commerce has been conducting arbitrations successfully between the business men of many nations for the past four years. We know in our own field, from experience, what arbitration can do. We see no reason why its principles may not be applied to disputes of all sorts between the nations, to the vast benefit of all.

Probably most business men will agree with the general view that the Paris Pact outlawing war, while a great step forward, cannot be regarded as a final step. No one would wish to underestimate its importance. If its pledges are honestly and earnestly accepted and adhered to by the nations which sign this treaty, it is difficult to estimate the advantages which will accrue from it. It is to be assumed that the nations mean what they say when they sign this agreement. If in the future there

are any indications of insincerity, then the people must inflict deserved punishment on those who mislead them.

Inspiring as this progressive development is, however, I think we should all realize that it must be followed by other necessary steps. Not the least important of these, it seems to me, is settlement of the question of how disputes between nations are to be adjusted if the danger of conflict arises. In my opinion so far as the United States is concerned, there is no room for doubt that, without delay, this country should take its proper place in the World Court.

Clearly, the Pact, promising as it is, will not mean what is claimed for it unless it leads promptly to effective reduction of armaments. If the signatures of the nations to this agreement are really worth anything, they mean that war is being renounced. If they do not propose to have wars in the future, then there is no justification for maintaining military establishments on any scale comparable with the past. Armies and navies must be reduced to the lowest possible point if the Pact of Paris is an honest document. The test of its honesty will be real achievement in this direction, and without undue delay.

There is one feature of this problem of disarmament which business men familiar with the facts are a good deal puzzled about. Some of our statesmen in this and other countries tell us that navies, for example, must be maintained at certain standards in order to protect trade routes in time of war. Many of us are unable to understand this argument, for we know very well that the conduct of world commerce on any considerable scale under conditions of modern warfare becomes impossible.

War now-a-days enlists the efforts of the entire civil population. All industry must be mobilized for war work. Import trade must be limited strictly to essential war supplies. The nations engaged must almost completely suspend production for export. There are no trade routes of any importance left to protect. Even if products for export were available, it is not easy to see how any nation at war could possibly maintain a navy big enough to protect the movement of any substantial number of commercial ships to distant points. Certainly no one country could do this and at the same time assure the importation of indispensable war material if the enemy nation possessed an important navy.

I am sure that business men would agree that the release of capital and man power which would follow a real reduction in armaments and armies would give such an impetus to the constructive activities of business throughout the world as we cannot now comprehend. In our own country during the last ten years we have had some opportunity to observe the effects of the reduction of war taxation.

For what it promises as an introduction to further progress, the Treaty of Paris should have the unstinted support of every patriotic American. It gives new hope. If war is to be suppressed effectively, however, there is still much to be done.

Who can doubt the desire of all peoples for a Peace which shall endure? Its achievement is the task of statesmen — not politicians. It will be accomplished only by those who courageously lead — not those who timidly follow. Its negotiation demands not merely knowledge, but tolerance, patience, persistence and sympathetic understanding of human weaknesses.

As always in the past every effort of the enlightened leaders of the world to secure peace will command the unreserved support of American business. In these efforts the business men of the United States share the wish of all other citizens that America shall not only coöperate but lead.

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THE SETTLEMENT OF JUSTICIABLE DISPUTES BY ARBITRATION AND INTERNATIONAL COURTS

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TO the two principal articles of the Kellogg Pact is applicable the comment made when the American patriots had signed the Declaration of Independence: "We must hang together or we must hang separately."

ARTICLE I

The High Contracting Parties solemnly declare in the names of their respective peoples that they condemn recourse to war for the solution of international controversies, and renounce it as an instrument of national policy in their relations with one another.

ARTICLE II

The High Contracting Parties agree that the settlement or solution of all disputes or conflicts of whatever nature or of whatever origin they may be, which may arise among them, shall never be sought except by pacific means.

The stirring renunciation of war as an instrument of national policy in article 1 will be made real only if the equally impressive declaration of article 2 be applied in the practice of nations. Disputes and differences will arise among the nations in the future, as they have arisen in the past; so if the machinery of adjustment of these differences cannot be developed to correspond with the will to peace which is its moral support and reason for existence, the declaration of article 1 cannot preserve the principle it proclaims. If no means to get rid of the social electricity arising from the friction which is inevitable in the closely organized world of today is provided, it will inevitably accumulate so that the outlet of conflict by force will result. If only by war can the state system and the law which governs it be adjusted to changing modern conditions, if only by force of arms can nations settle their quarrels, then war is inevitable. The Kellogg Pact is a stirring appeal to action, not a promise of quiet enjoyment of the fruits of peace on earth and good will among men.

Among the tried devices to assure peaceful settlement of disputes between nations is arbitration, and arbitration does more than merely settle differences. To return to the figure of frictional electricity: just as the electricity generated by friction can be used to light a street, so arbitration tribunals, called into being by the rubbing of national interests, may develop rules of jurisprudence which will serve to light the paths of international justice for the future. Just as our courts establish the law by repeated examination of the way a rule works in the many cases brought before them, so arbitration tribunals by their decisions point out to nations their respective rights and duties.

Arbitration is a very ancient institution. A settled world order cannot exist without some means of determining at least some disputes between governments by referring them to fair-minded men for a final judgment. The turmoil resulting from application of force, even short of war, to adjust all injuries, real or fancied, which one country believes it has suffered from another, would keep business from expanding abroad, would prevent international intercourse, and would render our civilization impossible.

Greek city-states had reached a stage in the development of internal order and of international trade and political relations which caused a considerable development of the practice among them. Later, in mediæval times, the degree of external independence of free cities and great feudatories made their relations resemble those of independent states, and again they turned frequently to the arbitral method of settling disputes instead of going to war. It is in our own time, however, that the international need for a judicial settlement has become most impelling, and has caused the greatest progress and refinement of the institution. A striking and encouraging instance in the development of the judicial settlement by arbitration of a very annoying class of disputes between governments appears in the development of the international procedure for dealing with private injuries. In the troubled times at sea which followed the fall of the Roman Empire, no prince or city existed able to protect subjects from attacks of pirates or the seamen of other states nearly as ruthless as the pirates themselves. Only by self-help, by taking a vessel of the same state

which had wronged him, could a merchant recoup himself for his losses. The state was not strong enough at home to compel payment for the depredations of its people upon others, nor would it have an interest in doing so, so that the only chance the individual foreign merchant had was to do justice to himself by treating the whole of the citizens and property of the offending state as a unit and taking from their ships or goods a fair payment for what he had lost.

Gradually the powers of the state were consolidated, the administration of internal justice improved and the practice of negotiations between states developed. The practice of self-help was then recognized as fatal to orderly international relations and a cause of war. The princes, however, could not stop the practice entirely since there was no other way finally to assure justice, so the next step was the regularizing of self-help by requiring the injured merchant to apply to his prince for an official permission to recoup himself by his own effort for his loss. Treaties intervened which regulated this recognized custom and required diplomatic negotiations to try for settlement in advance of the issue of the letter of marque which authorized the injured merchant to pay his own losses out of any ship of the offending state which he could capture. The letter of marque was a formal grant by the king and authorized reprisal only to the equal of the value of the property taken from the applicant. By the time of the French Ordinance of 1681, the king could say that he would issue letters only after proof of loss and only after proper representations had been made to the sovereign of the state of the offender and a request had been made for repayment under the provisions of existing treaties.¹ A vessel taken in reprisal must be condemned in the regular way and if the amount realized from the sale of ship and cargo was more than enough to cover the amount lost, the balance was held for the true owner. The holder of a letter of marque must put up a bond and was liable to fourfold damages if he made a capture which was not covered by the letter, or in case of fraud. An interesting case in Cromwell's time will show how the then modern procedure was worked. The ship of a certain English Quaker was taken on the coast of France. The merchant appealed to Cromwell who gave him

¹ *Code des Prises*, XXVII.

a letter to Cardinal Mazarin at Paris. The French Government failed to give redress and the merchant returned to the Lord Protector with empty hands. Cromwell did not give the petitioner a letter of marque, but sent a ship of war to bring in two French ships, which were sold, the Quaker merchant was paid his damages, and the balance was held for the account of the owner.²

What would be the result in modern international society if governments acted today as Cromwell did? The better organization of courts and international government, an increase in the sense of justice, has made it possible for a foreigner generally to enforce respect for his rights and redress for wrongs; and the improvement in the procedure of negotiation between governments since the seventeenth century and the use of claims commissions to settle the cases which internal justice or negotiation are not able to solve have completely done away with a custom of permitting redress of individual wrongs by self-help, which was defended as reasonable by the writers of the seventeenth and eighteenth centuries.³

The advance in internal and international organization which has created courts of arbitration and claims commissions to redress wrongs done to citizens of one country by citizens or governments of another and thus to substitute for self-help by reprisal, first negotiation and finally the judicial method, is an earnest that eventually in respect to larger issues of right between the nations a similar transformation will come about which will do away with general reprisals—that is to say, war. The Kellogg Pact and the spirit arising from it should work mightily to bring about this result.

Arbitration cannot alone preserve the peace. It is a judicial institution, and it is fitted, like the courts in our own country, to offer a way to settle disputes in particular cases and so slowly develop the customary law of nations along more or less recognized lines. It is not capable of serving the purpose of adjusting international law and international custom to the rapidly changing conditions of international life in the modern world,

² Butler, *The Development of International Law*, p. 175; Bonfils, *Droit international public*, secs. 981-982.

³ See Vattel, Book II, chap. xviii, sec. 347; Grotius, Book II, chap. ii, quoted in Walker, *History of International Law*, p. 313.

nor can it be used as a means of modifying treaties. That is law-making, a function going deeper into the roots of international differences, differing from the judicial function in methods and in objects, and being developed hesitatingly to meet the obvious need of the conciliation of the dynamic forces which are abroad in the world.

The national society finds necessary an orderly adjustment of contesting interests by legislation, in addition to judicial adjustment; the international society is subject to the same need. Only by the orderly procedure of legislation can internal revolution be avoided; only by a corresponding procedure can revolution in the state system, marked by world war, be conjured away. Thus the judicial process through arbitration or a Permanent Court cannot alone assure international peace, as an ordered judiciary alone cannot long assure peace in a nation. Indeed since the modern judiciary is essentially intended to protect rights as the law establishes them, and is, therefore, normally a supporter of the existing order and of the existing rules, the development of an international judicial system to protect present rights calls imperiously for its counterpart, the development of an international legislative system, of a great council of the nations, to provide a peaceful means for modifying the law which establishes those rights and for adjusting the political differences which the governments do not consider appropriate to submit to a judge. That an international judicial system cannot alone guarantee peace, does not, however, detract from its importance. It is just as impossible to imagine a peaceful society of nations without international judges, by whatever name they are known, as it is to imagine a national state without its courts. Confidence that an institution exists to protect rights not only will tend to diminish encroachment by aggressive governments in the world, as by aggressive individuals in the nation, and thus by its very existence tend to make negotiation more successful, but it will assure the weaker nation of an opportunity to bring the case into the open, where behind the international judge, as the sanction of his decision, stands that opinion of mankind a decent respect for which is after all the surest guarantee of the Kellogg Pact.

The United States has played a great part in the improve-

ment and increased use of the institution of arbitration. As colonies and in the early days of independence they became accustomed to referring to arbitration boundary and other disputes, so that when the Republic took its place among the nations, its public men, reminiscent of their experience in the limited state society of America, resorted nationally to the same procedure in the world society into which the country had entered. Under the Jay Treaty with Great Britain in 1783 threatening disputes over rights on both sides, involving large individual claims against the governments, were submitted to arbitral tribunals composed of individuals selected by the governments. This striking use of the judicial method in such cases, even when the application of important rules of the law of neutrality must decide whether or not the government was liable, marked the beginning of an era of advance. It capped the development which today has substituted judicial tribunals for self-help in cases of individual losses.

The Alabama Claims Commission marked a second step. Feeling in both the United States and Great Britain had run high over the question of the breach of neutral duty by Great Britain in allowing the Confederate cruiser to leave her ports. An explosion appeared to threaten. Attention was drawn universally to the dispute. The action of the two governments in submitting to an arbitral decision a matter involving their honor and an important pecuniary interest made a strong impression on the international society.

Thirdly, it was the United States which submitted the first case, the Mexican Pious Fund matter, to the Permanent Court of Arbitration at The Hague, the first effort of international society to organize permanently a judicial function.

During the period of growth of international law and the multiplication of international relations which marked the nineteenth century, the practice of arbitration not only became common but developed along lines which led to its more generalized acceptance in the twentieth. Disputes concerning national questions, as distinguished from claims conventions, were early normally submitted to the chief of a third state. This led to the risk that not rights but the chances of a friendly compromise, by which the goodwill of both parties would be retained, would move the arbitrator. Even in some cases he

was authorized to compromise, as notably in the dispute between Great Britain and Portugal over territory in Africa in 1872 the President of the French Republic as arbitrator was expressly permitted to make a compromise if he could not decide on the basis of rights. The Tsar in 1890 made it a condition that a similar provision be included in the agreement by which he was made arbitrator of the boundary of Guiana in a dispute between France and Holland.⁴ In neither case did the arbitrator have recourse to his extraordinary power, as the question proved capable of solution by the judicial method.

Naturally the chief of state named as arbitrator did not himself act as judge. The question was delegated to experts who advised him as to the law and the facts and prepared his opinion. Nevertheless there was always a possibility of political motives' entering the solution, and furthermore, the real judges, the sovereign's advisers, were not brought into the open and squarely faced with the personal responsibility for their judgment. Far preferable was the method followed by the United States and Great Britain, in the Alabama affair, where a bench of judges was created before whom the process was argued, who openly pronounced their judgment and bore the whole responsibility. Thus not only was the arbitration itself based on the principle of a settlement of rights, but the decision was taken from a political authority and put upon the shoulders of a bench of judges bound to apply the rules as laid down for them by the governments submitting the case, or the applicable rules of international law.

This sharp differentiation in personnel as in principle between political and arbitrable disputes was the basis of the great step taken in the Hague Convention of 1899. The assembled delegates recognized that experienced men should sit on arbitral tribunals with a full sense of their responsibility, and that they should decide, as the treaty has it, "on the principle of respect for the law." To facilitate the selection of such judges, a panel was created through the appointment of qualified men by the signatory states, and another step towards simplifying and regularizing the process was taken in the rules of procedure adopted for cases before the Inter-

⁴ Renault, *Revue générale de droit international public*, vol. I, p. 44.

national Court of Arbitration. A final step in advance has been the creation of the Permanent Court of International Justice, an established bench of salaried judges, thus incorporating in a definite organ the highest expression of the international judicial function.

The Permanent Court, however, in the principles which govern its action, does not differ from the ordinary arbitration tribunal. Like them it derives its authority not from a government but from the consent of the litigants, who determine whether a particular case shall be laid before it and thus control its jurisdiction. Even the obligatory clause of the Court Statute is based on an agreement in advance of the happening of a dispute, that it shall be submitted to the Court, so that when one state which has signed that clause is summoned into court by another signatory, the Court's jurisdiction is derived not from law or the authority of government but from the consent of the parties. What Sir Edward Fry said in the Second Hague Conference is true as to the Statute of the Permanent Court:

Arbitration, in all its forms, springs from the free consent of the Powers at variance; and the only difference between what is called obligatory arbitration and non-obligatory arbitration is that in the first case consent is given in advance, while in the second consent is given after the difference has arisen. In both hypotheses it is in substance only a question of a sovereign act by the Powers at variance, which in no way affects their independence, any more than the making of a contract interferes with the independence of the individual contractant.⁵

In the Permanent Court, as in other international tribunals, representation of the parties on the Court is assured. Should there not be on the bench a judge of the nationality of one of the parties to the case, that party is entitled to special appointment of one of its nationals as a judge.

The advance noted by Sir Edward Fry, and made more remarkable by the Covenant of the League, has been possible through the recognition of arbitration as a judicial process based on rules of law. It was a great step forward in principle, when nations began to bind themselves in advance to arbitrate their differences. The movement began very

⁵ *Reports to The Hague Conferences of 1899 and 1907*, edited by James Brown Scott, p. 432.

cautiously with the limitation that matters involving the independence, honor and vital interest of one of the parties, or the interests of third states, were reserved. In the First Hague Conference in 1899, so enlightened an international lawyer as Professor Max Huber could say that Switzerland could not accept an obligatory treaty of arbitration without reserves of independence, honor and vital interest. So limited an agreement to arbitrate in advance was more theoretical than positive; any question which a state was not ready to submit could be claimed by it as in one of the three categories, and that decision was final; one party unwilling, there could be no arbitration.

The importance of a just idea in the world, however, has never been better illustrated than the progress of the compulsory arbitration. The spread of such treaties in the first decade of the century testified to popular support and approval of the principle, and with the tremendous acceleration of world organization in this century, the movement has not only shown an advance in the number of treaties signed, but in the nature of many of those agreements. The reserves of honor, independence and vital interest, thought essential in 1899, have been completely abandoned in the latest type, although they still persist in many conventions.⁶ The Swiss Confederation tempered the reserves in its treaty of arbitration and conciliation with Germany of December 3, 1921, by a provision (art. 4) that whether a question "is one which affects its independence, the integrity of its territory or other vital interests of the highest importance" shall be submitted to arbitration, thus withdrawing the exception from the arbitrary decision of either government. Subsequently, in its treaty with another neighbor, Italy, the Helvetic Republic went further and agreed that *all disputes* not settled by conciliation shall be submitted to the Permanent Court of International Justice.⁷

The treaties signed at Locarno mark the most striking advance in the practice of the nations during the twentieth century. Germany, contracting separately with France, Belgium, Poland and Czechoslovakia, agreed that "all disputes of every kind . . . with regard to which the parties are in con-

⁶ *Arbitration and Security. League of Nations Doc. C, 32, 1926, V., p. 5.*

⁷ Treaty of September 20, 1924.

flict as *to their respective rights* and which it may not be possible to settle amicably by the normal methods of diplomacy, shall be submitted for decision either to an arbitral tribunal or to the Permanent Court of International Justice." Thus a high mark of confidence in judicial settlement between nations was registered.

In another way has international compulsory arbitration been rapidly gaining ground. Even before the war separate treaties sometimes contained clauses submitting to arbitration all disputes arising out of the execution of the treaty. Since the establishment of the League of Nations and the Permanent Court, it is not too much to say that this clause tends to become generalized, so commonly is it found. The Peace Treaties set the fashion which has been so largely followed that the *Fourth Yearbook of the Permanent Court* shows the clause contained in sixteen multilateral conventions regulating matters of general interest, like the Barcelona Conventions on International Transportation, the Air Navigation Treaty, and more striking still, in sixty-four political conventions between two powers, including thirty-six states. Treaties of commerce are the most numerous class in this list, but there are also arbitration agreements appointing the Permanent Court as final arbiter between the parties. This wide jurisdiction is in addition to that conferred by the Treaties of Peace or by the adhesions to the obligatory article of the Statute of the Court.

With the advent of general treaties of arbitration by which governments in advance agreed to submit differences to an arbitral decision, the question of the character of the institution came within the field of practical politics. When special agreements were negotiated in respect of each particular case submitted to an arbitrator, the contending governments would have to agree that it was suitable to arbitration before the agreement could be concluded. However, when they agree in advance to submit cases, the governments must determine what they mean by a dispute suitable for arbitration. In the early general arbitration treaties this classification was attempted haltingly. Statesmen are disclosed in the first decade of this century "standing with reluctant feet, where the brook and river meet". Thus the early treaties contained the reservation of honor, independence, vital interests and interests of

third states, and in the United States the still more effective check on precipitate action, that no case should be submitted without the consent of two-thirds of the Senate. These early treaties were little more than the declaration of an intention. However, there appears from the first the principle that only in regard to differences of a legal nature or involving the interpretation of treaties, would the governments bind themselves even in this vague way. These treaties followed the first Hague Convention, which declared in Article 16 that—

In questions of a legal nature, and especially in the interpretation or application of International Conventions, arbitration is recognized by the Signatory Powers as the most effective, and at the same time the most equitable, means of settling disputes which diplomacy has failed to settle.

Baron Descamps, explaining this section in the First Conference at The Hague, remarked:

To say that the arbitrator is judge and acts according to law is to say that arbitration is not applicable to every variety of dispute between States. Differences where the opposing claims of the parties cannot be stated as legal propositions are thus, to some extent, by their very nature, outside of the jurisdiction of an institution called upon to "speak the law". Conflicting interests, differences of a political nature, do not belong, properly speaking, to arbitration.⁸

The distinction thus marked out, that arbitration as a judicial procedure could only be applied where the dispute was capable of being settled by applying the law, appears in another form with more extended application in the Locarno Conventions and in the recent treaty between the United States and France, by which the countries agree to submit all disputes where "the Parties are in conflict as to their respective rights", or as the Briand-Kellogg Convention has it, "All differences . . . in which the High Contracting Parties are concerned by virtue of a claim of right". New reservations are substituted for the old formula respecting national honor and vital interests, and the United States still reserves the condition that each case requires the consent of two-thirds of the Senate, so under the general treaty alone no arbitration can be had.

⁸ Baron Descamps' report from the 3rd Commission on the Pacific Settlement of International Disputes to the First Conference at The Hague.

The Kellogg-Briand Convention adds that differences subject to arbitration must be "justiciable in their nature by reason of being susceptible of decision by the application of the principles of law or equity", thus making it clear that only legal rights are involved. The Statute of the Permanent Court applies the same principle in article 38. Thus the controlling statesmen of the world, pressed by insistent public opinion, have proclaimed that all disputes over rights shall be arbitrated and that they mean by this that the law shall be applied to determine on which side lies the right. In few cases (the treaty between Italy and Switzerland has been noticed) do the governments go as far in dealing with one another as they compel individuals to go in the national jurisdiction, that is, to submit all cases to the judges for a final decision. The French Code lays down the rule that no judge must refuse to decide a case because of the lack of or uncertainty in the law; settlement by the opinion of a fair man is better than continued contention as a matter of internal public policy, but the world has not advanced to that point in establishing its public policy. The Statute of the Court has gone in advance of its times, however, and to cover the few instances which may call for its application, empowers the Court to decide a case "*ex aequo et bono*, if the parties agree thereto".

Negotiation of general treaties of arbitration in recognizing so definitely the judicial nature of the institution, and in requiring the application of principles of law by arbitration, only confirmed the opinion of the writers. Says Judge Moore:

Arbitration...represents...the application of law and of judicial methods to the determination of disputes between nations. Its object is to displace war between nations as a means of obtaining national redress, by the judgments of international judicial tribunals; just as private war between individuals, as a means of obtaining personal redress, has, in consequence of the development of law and order in civilized states, been supplanted by the process of municipal courts.⁹

Professor Lammasch declares: "Like a national court, the modern arbitral court is required to declare legal rights (*Recht sprechen*); to bring about by mediation a compromise between the parties is not within its competence. The court must apply the law and where it is not clear, use the method of analogy."¹⁰

⁹ Moore, *Digest of International Law*, vol. VII, pp. 24-25.

¹⁰ *Handbuch des Völkerrechts*, p. 174.

A French writer, Merignhac, who has given the subject great attention, concludes: "The arbiter . . . should take the law of nations for his guide if the agreement of submission is silent."¹¹

Bonfils aligns himself with the prevailing view of the authors:

Arbitrators are not mediators. In practice they often propose a settlement to the parties and if a friendly arrangement cannot be brought about, they pronounce their decision but they should decide according to the established and approved rights of the parties. In principle they cannot impose a settlement [*transaction*] but parties may charge the arbitrators with a duty of settling formally the difficulty between them.¹²

Professor Jessup cites Professor Charles Cheney Hyde:

that in the light of the practice of states it can be said that arbitration is used in the technical sense of referring to "an impartial adjudication according to law, and that before a tribunal of which at least a single member, who is commonly a national of a state neutral to the contest, acts as umpire."

Professor Jessup adds a declaration by the late Professor John Westlake, for a long time legal adviser to the British Foreign Office:

The essential point is that the arbitrators are required to decide the difference—that is, to pronounce sentence on the question of right. To propose a compromise, or to recommend what they think best to be done, in the sense in which the best is distinguished from the most just, is not within their province, but is the province of a mediator.¹³

Professor Philip Baker recently stated that:

arbitration was definitely recognized before the war, both by governments and by lawyers, as a judicial process. This recognition was indeed already given in principle in the first attempt made in 1899 to organize in the first Hague Convention for the Pacific Settlement of International Disputes a general system of arbitral procedure.¹⁴

Arbitrators themselves have stated their view of their function in no uncertain words. Reference has already been made to the request of the Tsar for authority to go outside his duty

¹¹ *Traité théorique et de l'arbitrage international*, p. 192.

¹² Bonfils, *Droit international public*, § 952.

¹³ *International Conciliation*, No. 239, *The United States and Treaties for the Avoidance of War*, by Philip C. Jessup, p. 182.

¹⁴ *British Year Book of International Law*, 1925, p. 78.

as arbitrator if he could not determine the line in Guiana according to rights of the disputants, a striking evidence of his conception of the limits of the duty of an arbitrator. Lord Cockburn, the English judge, in the Geneva Arbitration said: "We are here as judges". Count Sclopis, of Italy, added: "It is not necessary for Lord Cockburn to state that we are here as judges. We have all felt from the commencement and still feel a deep appreciation of our duties as such."¹⁵

Baron Lambermont wrote "in a letter to the German and English ministers in connection with an award made by him: 'Arbitrator and not mediator, I had only to give the law and could not enter into the domain of bargaining.'"¹⁶

Mr. Ralston cites the Aroa Mines case:

So in the Aroa Mines case [Venezuela Arb. of 1903, 344, 386] Umpire Plumley declared that: "International law is not in terms invoked in these protocols, neither is it renounced. But in the judgment of the umpire, since it is a part of the law of the land of both governments, and since it is the only definitive rule between nations, it is the law of this tribunal interwoven in every line, word, and syllable of the protocols, defining their meaning, and illuminating the text; restraining, impelling, and directing every act thereunder..."¹⁷

Mr. Ralston, himself an arbitrator of experience, concludes after a study of the cases: "In short it may be said that however appointed, and under whatever limitations of power they may have exercised their functions, it has been the well-nigh universal rule that arbitrators have acted judicially."¹⁸

An examination of the decisions of any claims commission will show the care with which the arbitrator attempts to find a general principle to apply to the facts of the case before him, using as his guide the recognized rules of international law and the decisions of other arbitral commissions. So the decisions of the arbiters in important cases like the Geneva award, the Fur Seal arbitration, and boundary questions, will be found based on the rules of law so far as applicable.

If frequently the rule of law is obscure, if the arbitrator is forced to decide by the use of analogy, and by applying his

¹⁵ Moore, *International Arbitrations, History*, vol. I, p. 648.

¹⁶ Moore, 4946, cited in Ralston, *Law and Procedure of International Tribunals*, p. 37.

¹⁷ Ven. Arb. of 1903, 185, Morris' Report 21, cited in Ralston, *op. cit.*, p. 3.

¹⁸ Ralston, *op. cit.*, p. xxxvi.

knowledge of general principles, the situation in international is not different from that in national courts. Chief Judge Cardozo of the New York Court of Appeals, lately wrote: "It is when there is no decisive precedent that the serious business of the judge begins."¹⁹ How far the exercise of the judicial function in national society may depart from a mere application of a readily found rule, the Chief Judge joints out:

When the law has left the situation uncovered by any pre-existing rule, there is nothing to do except to have some impartial arbiter declare what fair and reasonable men, mindful of the habits of life of the community and of the standard of justice and just dealing prevalent among them, ought in such circumstances to do with no rules except those of custom and conscience to regulate their conduct.²⁰

The idea of arbitration has progressed farther in the past fifty years and especially in the twentieth century than in all preceding time. Courts of arbitration composed of experts have been recognized as more suitable than chiefs of state to decide the cases which come within the scope of the institution, and this recognition has been carried to its logical end by the creation of the Permanent Court of International Justice, even though the litigants insist even in the Court on having a judge of their own on the bench and thus testifying to the importance of national points of view in the consultation chamber or in the public hearing. In place of special agreements to arbitrate particular cases has come a wide acceptance of the principle of compulsory judicial settlement of rights, and the scope of agreements embodying the principle would have seemed chimerical to statesmen of fifty years ago.

The test of whether the statesmen have progressed too fast will come with the application of the generous terms of the newer treaties, including the Statute of the Permanent Court. If the advanced position is to be sustained there will be needed all the international good will of which the Kellogg Pact is the latest expression. There is no international sheriff to summon a recalcitrant nation into court, no international police to enforce the judgment. "Obligatory arbitration" depends for its compulsory character on public opinion primarily in the countries concerned in the dispute, the secondarily in the world at large.

¹⁹ Cardozo, *Nature of the Judicial Process*, p. 21.

²⁰ *Ibid.*, p. 142.

THE SETTLEMENT OF POLITICAL DISPUTES THROUGH CONFERENCE, CONCILIATION AND DIPLOMACY

DAVID HUNTER MILLER

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The Drafting of the Covenant, The Peace Pact of Paris, etc.

SO great is the attraction which names and labels have for the human mind and so great is their influence on human thought that we are apt to feel almost instinctively that if international disputes are either justiciable or political, there must be some objective test, some definition, which will enable us to list any and every such dispute clearly and absolutely in one group or the other. I venture to suggest that this view is unsound. At least I think it can certainly be said that there does not now exist any objective test, any classification, which can be regarded as final. Here as elsewhere the theory of international relations is by no means static.

Historically the distinction between justiciable and political disputes depended upon the act of the parties; it was wholly subjective. This statement is supported by the very high authority of the Supreme Court of the United States in the famous case of *Rhode Island v. Massachusetts* (12 Peters, 787) where it was said:

We are thus pointed to the true boundary line between political and judicial power and questions. A sovereign decides by his own will, which is the supreme law within his own boundary, a court or judge decides according to the law prescribed by the sovereign power, and that law is the rule for judgment. The submission by the sovereigns, or states, to a court of law or equity, of a controversy between them, without prescribing any rule of decision, gives power to decide according to the appropriate law of the case; which depends on the subject matter, the source and nature of the claims of the parties, and the law which governs them. From the time of such submission, the question ceases to be a political one, to be decided by the *sic volo, sic jubeo*, of political power; it comes to the court, to be decided by its judgment, legal dis-

cretion and solemn consideration of the rules of law appropriate to its nature as a judicial question, depending on the exercise of judicial power.

and it is very interesting to observe that in the argument for Massachusetts objecting to the jurisdiction of the Supreme Court, Counsel said:

Massachusetts maintains that before she can be called upon to submit her controversies to a judicial decision a court must be established, a law made or a code propounded suitable to the decision of her case; and the forms of process, mode of procedure, character of judgment and means of enforcing it be first established by legislative authority.

That argument, which the Court rejected, sounds almost as if it had been quoted from recent assertions of the necessity of the complete "codification" of international law as a condition precedent to international judicial decision. The proponents of this theory fail to recognize the truth thus phrased by Judge Cardozo: "We do not pick our rules of law full blossomed from the trees"; and I may add, we never shall.

The opinion of the Supreme Court from which I have quoted was handed down nearly a century ago; and there is no doubt that efforts which have been made, particularly in recent years, to establish an objective classification of international disputes have met with some success. These efforts have usually, though not always, adopted the method of defining certain classes of disputes as justiciable and leaving the general residue of others under the heading, "political".

It would be going beyond my province here to review this chapter of legal history. So far as treaties are concerned, the best known list of disputes suitable for legal decision is that of the Covenant of the League of Nations in article 13 which adopted the wording previously suggested by the group of jurists in England headed by Lord Bryce; that list in turn was in substance taken over into the Statute of the Permanent Court of International Justice; but the Treaties of Locarno have a very different formula and our own treaties of arbitration still another and one very much more limited. Curiously enough, however, the American arbitration treaties, limited as they are, seem to have as a background somewhat the same idea of the line of distinction between political and justiciable dis-

putes as have the Locarno Treaties. Our treaties speak primarily of a "claim of right made by one against the other under treaty or otherwise"; and the Locarno Treaties say: "Any question with regard to which the parties are in conflict as to their respective rights shall be submitted to judicial decision".

I may conclude this introduction with two more quotations which show how complete a divergence of thought as to the theory and practice in this regard still exist. On March 15, 1928, Secretary of State Kellogg said: "A political question cannot be arbitrated because there are no principles of law by which it can be decided". A few days earlier a very distinguished English authority and one with great experience in international affairs, Sir John Fischer Williams, went so far as to give this opinion: "I believe that there is no international conflict possible which, were it referred for decision, the Permanent Court of International Justice would be compelled to declare itself incompetent to decide"; and, as illustrating the length to which his view went, Sir John Fischer Williams added that the legal answer to the amount of the German reparation debts would be the same as that of a business man.

Coming perhaps closer to my topic, "The Settlement of Political Disputes through Conference, Conciliation and Diplomacy", it must be admitted that here by "political disputes" we mean political disputes subjectively; in other words, we include disputes, all disputes, that the parties choose to settle or seek to settle by any one of those three means: conference, conciliation and diplomacy. Such disputes may include, and very often do include, those that under any theory would be perfectly susceptible of judicial decision. But as the parties themselves prefer to adjust them, say, through the diplomatic channel, they must be regarded for our purpose as political disputes although they might have been referred to a tribunal.

Furthermore, many of the subjects of discussion and adjustment in international conferences or by diplomacy are only to be regarded as "disputes" if we give that word a very broad and extensive sense. We must consider the term to be inclusive of matters as to which there is no actual dispute at all but perhaps only a potential cause of dispute and perhaps not even that; the matter may be one about which agreement is

essential but in respect of which a dispute in the ordinary sense of the word is highly remote. It is difficult here to draw a line by any general statement, so I shall mention one or two concrete examples.

Take the matter of the postal service. Here international agreements go back some generations. There has been built up a very large body of law and custom under which deliveries by post are internationally exchanged all over the world. To come to a little later time, the rules of the road at sea cannot be simply for the ocean liners of one flag but must include all; and here agreement is so needful that disagreement seems impossible. The most modern instance, I suppose, is radio. Wherever the waves, if they be waves, stop, if they do stop, it is certainly not at or above international frontiers. Here at least, the words of Lewis Carroll were prophetically true:

“What’s the good of Mercator’s
North Poles and Equators
Tropics, Zones and Meridian Lines?”
So the Bellman would cry;
And the crew would reply:
“They are merely conventional signs.”

So we must make, and are making, our agreements regarding what we call “the air”.

While in international relations the doctrine of the separation of powers, executive, legislative and judicial, is neither applicable nor appropriate, still such agreements are in part of an international legislative nature; they look to the future, provide administrative and other regulations and frequently set up administrative bodies; perhaps the most apt illustration of the possible range of such a treaty, even when bilateral, is to be found in the very elaborate series of agreements between Germany and Poland regarding Upper Silesia; the basic convention, which was followed by various others, covered over 300 pages; it even contained a clause providing for the subsequent correction of printers’ errors in the official text.

I think we cannot always draw a precise line between conference, conciliation and diplomacy in the settlement of international disputes; but let me notice first of all settlement by diplomacy alone, direct negotiations between, say, two powers regarding an existing dispute.

In the ordinary case, so far as the negotiations are carried on in writing, they consist in large part of reasoned presentations of the respective positions, statements of the facts, with discussion and conclusions as to the law. There is nothing new in this style of diplomatic note; while not exactly in the same category, we can think of the great controversy between Selden and Grotius early in the seventeenth century as one of its precedents; but now-a-days the reciprocal exchanges between the disputant powers are quite along the lines of written arguments before a tribunal. It is perhaps not generally appreciated how vast a repository of international law is constituted by notes of governments. The full title of Judge Moore's great *Digest* begins with these words *A Digest of International Law as embodied in Diplomatic Discussions* and so on.

Certainly diplomatic notes serve a most useful purpose. They are invaluable and indispensable. Much more often than not they bring the parties toward a common accord and at least toward a common understanding. Their reasoned arguments are much better adapted to this end than admonitory speeches delivered by responsible officials and intended to be read in other countries, such as those, for example, which M. Poincaré was accustomed to deliver in 1923.

But diplomatic notes are not particularly well adapted to compromise. It is common experience, even in ordinary affairs, that proposals of concessions are usually not put in writing until after they have been verbally agreed to.

Now one of the very real and very modern changes in the procedure of international relations is the partial substitution of personal intercourse for communicated correspondence. This seems a simple thing; but its implications are very far-reaching. It is a commonplace to say that a meeting of interested individuals of any group at all brings out their different points of view, their divergence and their concurrence as well as the possibilities of compromise, much better and much more quickly than any other method of interchange of human thought. But there is something more to it than this; no individual can say to another just what he would write to him; you may read a prepared statement at a meeting; but I defy any one to talk a prepared statement. A conversation carried on in the form of diplomatic correspondence is as completely

impossible as would be a debate carried on in the form of equity pleadings. It is possible to write dialogue; but not even government officials could dialogue diplomatic notes.

So in the methods of conference and conciliation it is the element of personal intercourse that is perhaps of primary importance. As I intimated I do not think that any precise line can always be drawn between conference, on the one hand, and conciliation, on the other. Ceremonial and technical distinctions between different sorts of meetings of representatives of governments are tending to disappear; and while members of commissions of conciliation may in the strict sense sit as individuals and not as officials, even here the distinction is less real than it sounds; it was not very real, for example when three Americans sat on the Committee of Experts that drew up the Dawes plan. With increasing publicity in international affairs the world is properly coming to think more of results than of forms. Take, for example, a meeting of the Council of the League of Nations to settle an international dispute. Certainly that meeting is a conference. Clearly also it employs the method of conciliation, for the Covenant says that in the first instance "the Council shall endeavor to effect a settlement of the dispute." And also in addition to being both conference and conciliation, the procedure is that of diplomacy.

Indeed I may go farther. At any such meeting, whether of the Council of the League or not, the views of the Powers represented, other than the disputants, have both moral force and political weight. The recommendation of the Council of the League addressed to the two parties, if unanimous in the sense indicated, while technically only a recommendation, is really in the twilight zone between advice and judgment; and I may add that within that same zone is an advisory opinion of the Permanent Court of International Justice.

The forms and methods of international procedure in the settlement of disputes between states are not fixed. Visible changes have come in recent years and we can almost see them going on; and back of the changes is the urge that is embodied as a formal agreement in article 2 of the Briand-Kellogg Treaty that "the settlement or solution of all disputes or conflicts of whatever nature or of whatever origin they may be shall never be sought except by pacific means."

In past history there has been lurking in the background of all diplomatic intercourse the menace of force. If the ideal of the agreements of peace made in the last ten years and of the pending Briand-Kellogg Treaty is realized, nowhere will the change be more notable and apparent than in the field of diplomacy. The result there could not be better summed up than in the hope and prediction of the Marquess of Reading in the House of Lords last May when he said: "War . . . shall no longer figure in Diplomatic Notes which may pass between nations. No implication will be raised in any Notes of threats of war. All that is to disappear entirely."

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DISCUSSION¹

MR. ALLEN W. DULLES (former member of the United States Diplomatic Service): We have been discussing the machinery for the preservation of peace, and I want to present to you one or two questions that possibly may help to guide and aid in the discussion. One of the questions is this: What is the efficiency of this machinery?

The efficiency, the potency, of this machinery, it seems to me, will depend upon its adequacy to deal with the efficient war machinery. We have in every country a large number of individuals, grouped under various departments of the national governments, whose task it is to build up the efficiency of the war machinery. That means that when a crisis arises, they must be ready and able to put this machinery into motion in the shortest possible time and direct it to the point where it will be most effective. That is their duty. We can not quarrel with them if they do it well. The task of the rest of us is to try to build up a machinery which can be effectively availed of before the war machinery has got under way to a point where it can not be stopped.

In this scientific age we are trying to learn by analysis and by the laboratory system. We can learn many lessons by applying this system to what happened in 1914, and find out through analysis of that situation exactly why this peace machinery that we have been discussing fell down.

I have been spending some time recently, and possibly many of you have also, in reading over the Kautsky Papers and the Austrian Red Books, those very interesting publications which give all the telegrams that passed from and to Berlin and Vienna during the tragic days of 1914. What impressed me in reading these messages was the fact that the peace machinery never got started. Suggestions were made, but events moved too rapidly. Cables left London, with the best of intentions, but by the time they were decoded and read in

¹ An abstract of the discussion which followed the addresses by Messrs. Wickersham, Moon, Fahey, and Miller at the Second Session of the Annual Meeting of the Academy of Political Science, November 23, 1928.

Berlin, and submitted to the various officials to be acted upon, they dealt with a situation of twelve hours before. The peace machinery broke down. What have we done since 1914 to build up an effective peace machinery to supply the defects developed in 1914? It seems to me that those of us who have lived through the days of 1914 and the war have a great responsibility in trying to build up this machinery. Having lived through these experiences we ought to profit by them. Future generations can properly look to us and ask us what we have done to avert a repetition of 1914.

In Europe they have gone fairly far, through the League of Nations, through the Locarno Pact, and in other ways toward making the machinery of peace effective. We will very likely find that one of the most important elements of the Covenant of the League is the provision which requires the frequent meetings of the responsible heads of the European governments. It has many times been said, and I think with great truth, that if the European statesmen could have gotten together in 1914 for personal conference, the war would have been averted.

In the United States we feel we shall have, when—I say “when” because I think we do not need to say “if”—the Kellogg Pact is ratified, a basis in article 2 of that Pact on which to build up peace machinery of arbitration, conciliation, diplomatic interchange, and conference. All these have already been laid before you for discussion, consideration and analysis. I suggest another possible means of developing the machinery of peace. Science has been used largely to develop the weapons of war, such as the airplane and the submarine. Each development of science seems to have a use in war. Are there not many of the modern scientific developments that we can turn to a peaceful use and make a very effective part of our peace machinery?

As I suggested, the great difficulty in 1914 was that the men responsible for national policies were not together, they could not talk to each other; negotiations were impeded by the elaborate method of cabling back and forth. We now have the transoceanic telephone. That, I think, will be one of the great additions to our peace machinery. The radio, and even the airplane, may serve to overcome distance as an

obstacle to conferences among statesmen. In short, I venture to suggest that, in addition to the various other elements of our peace machinery to be developed, we can use science and turn it to peaceful ends.

MR. FREDERICK KELSEY (50 Church Street, New York City) : There are two or three observations that occur to me as being of vital importance at this time on this subject: In the first place, may I say that as a member of the Academy of Political Science for many years, and having attended many of the meetings, it seems to me this is the most important meeting that this Academy has had within my recollection.

The second observation is to refer to some of the points that have been made by Mr. Fahey in his splendid address on arbitration. I happen to be an active member of the Merchants Association of New York City. We have a membership, I believe, of something over seven thousand. When this question of arbitration came up, to which Mr. Fahey referred, the matter was referred to the members of the Association by a questionnaire, and about eighty-five per cent of the membership expressed an emphatic desire that the practice of arbitration, both national and international, should be carried forward. I have also followed some of the questions that have come before the International Chamber of Commerce, and, without going into detail or enlarging upon the statement made by Mr. Fahey, I want to say that the principle of arbitration has made progress that was deemed impossible twenty-five years ago and would still have been impossible ten years ago. To-day the great merchants of the world are adjusting their disputes under the principle of arbitration.

[Mr. Kelsey then referred to a conversation with Senator Borah on the World Court, the League of Nations, the Peace Pact, and the inter-allied debts.] The Senator had made a speech in New Haven in which he said that, following the policy of his predecessor, he was going to oppose the World Court. Not knowing Senator Borah, I wrote him what might be termed a pretty brash letter, to which I received no reply. A short time afterwards I saw him in Washington. I said, "Senator, most people come here to agree with you. I come here because I differ with you, and I have learned a great

deal more from people who differ with me than from those who agree with me." He replied, "Mr. Kelsey, that is just my experience, and I am very glad to talk with you."

Figuratively speaking, I pitched into him on the question of the League of Nations, then on the World Court, then on the interallied debts—in which I am keenly interested as a member of a committee of representative men endeavoring to bring order out of chaos in the present foreign debt situation. After I had given my reasons for favoring the World Court, the Senator said, "I do not believe in it without a codification of international law". I asked, "Senator, do you suppose you and I will live long enough to see a codification of international law?" When he expressed his objections to the League and the Court, I said: "Now, Senator, I want to ask you a simple question. You are a very able lawyer and I am just a layman. In your experience have you ever known a case where a national, state, or municipal court ever did any harm unless it had the power of enforcement—which is lacking in the World Court?" I am inclined to think that the Senator had never had the thought put to him that way before.

[In conclusion Mr. Kelsey stated that passing resolutions on questions of foreign policy was less effective than direct communication with senators, and suggested that a central committee representing the various organizations interested in foreign policies should go down to Washington to discuss these affairs "around a table, just as we do in business matters."]

MR. HENRY L. SHEPHERD, JR. (Princeton University, Graduate School of Politics) : It is undoubtedly known to all of you that morality is simply, generically speaking, that which is customary. According to that line of reasoning, warfare as a means of settling disputes is customary. In a very illuminating sermon Dean Wicks at Princeton University said that the trouble with the people of today is that they are bound by the staleness of conventional morality, and that what we need is original behavior. It strikes me that the proposal to outlaw war is in a measure original behavior. Some people will say that we cannot legislate new morals. They say that new morals or morals of any kind are the result of evolution and slow, gradual growth; but it seems to me that we have been

going through a long enough period of growth and now is the time to put in concrete form some standard of conduct.

MR. R. R. BOWKER (New York City) : The discussion of the national peace machinery and war machinery question brings us down to a hard fact. We have three vigorous war machines endangering the peace of the world. One is our Naval General Board; another is the British Admiralty; and the third is the French War Office, perhaps represented in a way by President Poincaré. The President and Senator Borah both, unfortunately, spoke out for peace machinery and then immediately proceeded—Senator Borah a week ago, and the President in what has been called here his “splenetic” address—to emphasize the war machinery, and left that thought in the minds of their hearers. It would seem, therefore, that our most important work is to do what we can to back the Committee on Foreign Relations of the Senate, and oppose the war machinery, which is represented by our Committees on Naval Affairs.

MR. ROBERT BADENHOP [In continuation of his remarks at the First Session, Mr. Badenhop discussed the important rôle of the press as a factor in stimulating international antagonism. He continued as follows] : I lived in England for two and a half years shortly after the close of the Boer War. At that time the *Daily Express* and the *Daily Mail* were telling so many half-truths and untruths about Germany that I said to my friends in England, “If this continues, it will mean war.” . . . The press of the world has tremendous power. The day after war was declared in 1914, with the exception of only one paper printed in the English language in New York, every paper here came out immediately against Germany. That was all prepared propaganda. The statesmen did not tell the truth in 1914. That war could have been prevented.

If you want to prevent war, try to make a law that no war can be declared by any nation without a referendum of its people. Believe me, the people of Germany, the people of Austria, the people of England, the people of this country, the people of France would not have voted for war if they had had the chance.

PART III
THE PRESERVATION OF PEACE
THE PACT OF PARIS

PEACE AND WORLD TRADE

NORMAN H. DAVIS

Former Under Secretary of State; American Delegate to World
Economic Conference

WE are living in a period of remarkably rapid and far-reaching changes in human habits and relationships. Science and machinery are so revolutionizing the activities, the powers, and the needs of men as to alter the conditions of life everywhere and create a new world environment. The result has been to make life richer and more expansive, but also more complicated. The nations, in their relations to one another, have been going through a process similar to that of communities that emerge from primitive conditions, when it becomes necessary, in the interest of the community as a whole, to limit the freedom of action of the individual and to establish coöperation. Heretofore nations, like individuals in primitive communities, have been a law unto themselves, but if they are to promote their own best interests, they must henceforth conform more to the principles and practices that obtain among individuals in civilized communities.

Social and economic ties have extended until there are no longer any isolated sections. The economic life of every nation has become so interwoven with that of other nations as to make them all increasingly dependent upon one another. Every man, every industry, and every nation is now part of a world economic unit. No industry is independent; and no nation is self-contained. Every man in the world who is at work is now working for some one else, and is also dependent upon the work of some one else. This interdependence has reached the point where the welfare of countless millions of people throughout the world depends upon continuous production and upon the peaceful and uninterrupted exchange of goods and services; and healthy economic life is so intimately related to healthy political conditions as to make peace essential to world trade and inseparable from it.

Within the past year and a half, there have been two events having quite an important bearing upon future peace and world trade. The first of these events was a conference held in Geneva during the month of May, 1927, known as the World Economic Conference. It was attended by delegates from all nations, appointed by governments but not speaking for governments. The chief purpose of this conference was to ascertain and to recommend what might be done to reduce economic conflict between the various countries and improve world trade, as this was recognized to be of increasing importance to the peace and material welfare of all nations.

As the delegates had no power to put their ideas or recommendations into effect, they merely endeavored to state such facts and conclusions as they could unanimously agree upon. It was assumed, however, that the weight of their authority would have a permanent, although perhaps gradual, effect upon governmental policies.

It was recognized that each nation has the sovereign right to establish such fiscal policies as it sees fit and to place restrictions on the trade and commerce of other nations seeking to cross its borders, but that a nation which exercises such a power wisely must consider the effect of its action upon the economic life of other nations and of the world as a whole, as well as upon itself.

Each delegation testified to the fact that the foreign trade of its country was being hampered and injured by barriers set up by other nations. They were all slow, however, to recognize or admit that perhaps their own country might be guilty of some of the very practices of which they most complained. Nevertheless, by taking a comprehensive view of world trade and commerce, it became apparent that the fiscal policy of a nation might seem wise when viewed at short range, but most harmful when considered in relation to the whole.

The most significant conclusions arrived at by the conference were, first, that international trade can in the course of time adjust itself to any reasonable tariff barriers, but that it cannot adjust itself to constantly fluctuating tariffs any more than it can to fluctuating currencies which cause financial instability; second, that the time has come to stop raising barriers to trade and to begin to reduce them; third, that an improvement in

world trade would benefit every nation; and fourth, that many of the problems which affect international trade can only be solved by coöperation and collective action.

In his concluding speech, the President of the Conference, in summing up the general conclusions, said that the progress of civilization inevitably involves an increasing interdependence of the nations. And one of the leading economists of the world recently said that:

Public opinion must be prepared for the conception that in the world of the future it will be normal for the countries to receive even the most essential of their products from other countries, which in their turn will be equally dependent upon international trade.

If, during the present century, the countries of the civilized world approach a state of permanent peace, the notion of small, self-supporting nations will become as obsolete as that of the self-supporting village of the Middle Ages.

The Economic Conference did not deal with political questions, but, recognizing that the cure of certain economic ills and the improvement of world trade would require political action, it specifically recommended the political measures that would solve some of the economic problems under consideration.

We have heard much talk in this country to the effect that the United States is interested only in the economic questions of Europe, and that we should therefore take part in economic settlements but steer clear of political settlements. It is time to stop such talk and to take a broader outlook.

When Napoleon III became Emperor in 1852, he appointed a banker, Baron Louis, as Minister of Finance. The currency and finances of France were in very bad shape as a result of revolutions. The new Emperor told his Minister of Finance that he relied on him to correct this situation. Baron Louis replied, "If Your Majesty will make good politics, it will be easy for me to make good finances."

Today it is even less possible to separate financial and economic from political problems, because we cannot have economic peace and progress without political peace and stability.

During the past decade, our banks and bankers have purchased and sold, mainly to private American investors, foreign securities and participations in foreign loans to an amount estimated at \$10,000,000,000. The transfer of funds which

was thus made from this country, that had a surplus, to countries in need of credit and capital, served many useful purposes. It aided in the stabilization of currencies and in the financial and economic rehabilitation of several countries. It increased their production and consumption and contributed considerably to the settlement of international accounts, including the transfer of payments on German reparations. After giving an impetus to the economic life and the purchasing power of other countries, these funds returned to this country in payment of surplus goods and products purchased here, which resulted in a corresponding increase in the volume of our production and sales. While our bankers and investors in effect furnished money to pay for our own exports, they rendered a valuable service to all concerned, for without the funds thus supplied by them, our foreign customers would not have been able to purchase so much from us and our exports would have been curtailed accordingly.

It is just as important today to find a safe outlet for surplus savings as it is to dispose of surplus goods. If anything should happen to stop the export of our surplus capital to countries where it may be safely and beneficially invested, the development of the countries needing capital would be retarded, the export of our surplus goods would fall off, and our production would also slow down.

The safety of foreign investments depends not alone upon the soundness of the respective enterprises and the strength of the debtors, but upon political stability, and also governmental policies which do not stifle trade and commerce.

The economic development of the United States, which has within recent years become the richest and most powerful of all nations, has attained to such proportions that its commerce crosses all national boundaries. Its production and consumption exceed that of any other nation, and yet it is not, and it cannot be made, economically self-sufficient. The supply of many raw materials and goods essential to its very existence must come from other countries, and in turn it must have an outlet abroad for its surplus products and savings. Its economic life and its prosperity have therefore become increasingly dependent upon the uninterrupted flow of trade and commerce in a politically stable world. And for this, it is more than ever necessary that the world shall be at work and at peace.

It is necessary to have peace not only in order to keep open the channels of trade and commerce and to supply and serve the material needs and interests of mankind, but also to satisfy the moral needs and aspirations of humanity. The peoples in many countries are today staggering under almost unbearable burdens inherited from past wars and those imposed in preparation of future wars, and they are pressing as never before for relief from such burdens and for the removal of the menace of war.

In response to the growing necessity and demand for the abolishment of war, the second event—to which I have referred—took place in Paris last August, when fifteen nations, including the United States (which was represented by the Secretary of State) entered into a solemn treaty renouncing war as an instrument of national policies. This treaty, known as the Pact of Paris, has since been accepted by many other governments, and now awaits the approval of the United States Senate to make it binding on this nation.

Since time immemorial, the right of a nation to wage war when it sees fit has been recognized as an inherent prerogative of sovereignty. It is only within the past decade that such a doctrine has been challenged and modified. The nations which became members of the League of Nations voluntarily entered into agreements limiting their freedom to exercise such a right, and the nations that signed the Pact of Paris last August actually renounced war as an instrument of national policy, and agreed never to seek a settlement of any controversy except by pacific means.

Prior to the World War, there was little or no real effort to do away with war as an institution. Statesmen directed their efforts mainly to the establishment of universal rules for waging war which would make it more humane for belligerents and less harmful to non-belligerents. The only plan for preventing war, especially in Europe where it was most prevalent, was to create through alliances such a balance of power as would make nations hesitate to seek a fight. That great war proved such a plan to be futile because, once nations are engaged in a death struggle for survival, they cannot be relied upon to keep agreements to fight according to certain rules. It demonstrated that war has ceased to be a private affair be-

cause a war between two or more nations so seriously affects other nations as to make it a matter of concern to all. It also demonstrated that it is no longer a paying enterprise because victors and vanquished were both losers and even neutrals were unable to escape.

It was not long ago that business in this country was conducted upon the theory that bitter cut-throat competition was wise and necessary. Competitors sought to destroy their rivals and even at times resorted to violent methods. That has now largely given way to the wiser practice of intelligent coöperation, which has brought greater returns and better results for all concerned. Through improved management and methods, which were thus made possible, efficiency has been increased, the standards of living have been raised and the general welfare has been greatly improved.

The theory also prevailed that the interests of capital and labor were in conflict, that between them there must exist eternal warfare. Gradually it was discovered, perhaps by accident, that more is to be gained by each in working together. Intelligent employers began to realize that laborers are customers as well as human beings and that the more they earn, the more they buy and the better they live. Labor, on the other hand, began to see that capital is not an inexhaustible something which can be tapped without regard to consequences; that it is only useful and valuable when productive, and that labor should therefore coöperate with capital in order to increase efficiency and the earnings of each.

In spite of the abundant evidence that the world has become an economic unit, and that strife and violence must give way to coöperation if civilization is to be preserved, governmental policies are still largely based upon the assumption that economic strife is beneficial and armed conflicts necessary. There is, however, an increasing realization on the part of people everywhere that civilization has reached a stage of development which makes it important that there be economic and political peace, and there is reason to hope that the pressure of enlightened public opinion will be reflected in a continuous improvement in governmental policies.

On account of the strong and rising sentiment in the hearts and minds of the people of this and of all countries in favor of

reducing armaments and of doing away with war, unusual interest is being manifested in the fate and the efficacy of the Pact of Paris.

While this treaty does not outlaw war, nor prevent the nations that accept it from going to war, it is a definite repudiation of the idea that brute force shall govern the policy of nations, or determine the destiny of mankind. It embodies in a general treaty the great ideal that nations, instead of trying to destroy one another, shall find orderly ways to compose their differences and to work together for their own and the common good. This is a distinct forward step towards abolishing war. It clears the ground for the planting of seed which may produce abundantly rich harvests if carefully and continuously cultivated. We must recognize, however, that it is by no means an easy task to uproot the age-long habit of nations to rely upon and resort to violence as the means of settling their differences. It is idle to suppose that the system of war, which is so deeply rooted after centuries of growth, can be eradicated merely by frowning upon it, or that an international law making it illegal would suffice. Such a law would not be any more self-enforcing than are national laws which do not enforce themselves.

Obviously the only way to do away with war is to find an effective way to substitute reason for violence. Nations will not surrender or radically reduce their arms unless the incentive, as well as necessity to use them, is removed. The only promising method for achieving this is by international agreements and international coöperation, supported by strong public opinion, which will provide means for settling disputes and protecting the rights and legitimate interests of nations by conciliation or by appeal to law as is done between individuals in civilized countries. To do that it is necessary to develop among nations the habit of settling their disputes in court, or around a common conference table, rather than upon the battlefield.

If we are to secure and enjoy the benefits of stable peace and world trade, political thought and action must catch up with the progress made by science and industry and be more alive to the trend of events and more responsive to the needs of mankind. The archaic, slow and ineffective custom of trying to

match minds and compose and solve international problems and differences by diplomatic notes and political speeches has been abandoned by most countries and superseded by up-to-date methods of conference and conciliation. We should follow their example. Just as it became necessary to establish clearing houses to settle accounts between banks, it has become necessary in this modern age to have something like a clearing house for expediting the settlement of differences between nations.

If we are to get over the costly habit of waiting for so-called Peace Conferences to patch things up after a war has taken place, we must learn to get together beforehand, and to coöperate constantly in the solution of problems that affect the welfare of the nations as a whole. It is wiser and easier to bring controversies out into the open in a conference and remove sources of friction before they reach such proportions as to get beyond control and end in war; and I for one have less fear of taking part in conferences held to *keep* the peace, than of attending those called to *make* peace.

This is becoming essentially an age of coöperation, and the value of it is evidenced by concrete achievement and improvement in every avenue of human endeavor in which there has been an accommodation to the forces that make for harmony and progress. The day is past when a nation can be a law unto itself and act entirely as it pleases, without regard to the effect upon others, or the reaction upon itself. A nation which is not economically independent, and cannot become so, is not wholly independent politically, and it cannot make itself independent or secure, no matter how powerful it may be, or how large a military force it may maintain. No nation should surrender its power or right to defend itself; neither should it carry its ideas of self-interest and security to the point of insecurity, for if it holds back and fails to fall into line with the forward-moving forces, it retards the general advance, and leaves itself in an unfavorable position.

We of America should not interfere or become involved in questions that do not concern us. Neither should we run the grave risk of holding aloof and leaving entirely to others the solution of problems which vitally affect us. Economically and politically our interests are bound up in world trade, the

limitation of armaments, the prevention of war, and the advancement of international justice. The problems relating to such matters are of universal interest and can only be solved by united effort; and America, which has the power and prestige to contribute so much to their solution, has a corresponding responsibility, and also an opportunity which it should not overlook to bring more harmony into world affairs.

The interests of this country are now so world-wide that its trade, prosperity and tranquillity depend largely upon its foreign relations. The advantages which it can derive from peaceful and profitable intercourse with all nations far outweigh any benefits that can possibly come from a blind and purely selfish nationalism that breeds ill-will and discord. There is for us and for every nation more profit, more security, and more progress in coöperation than in conflict. It should, therefore, be our endeavor to lift above the prejudice and confusion of partisan strife all questions bearing upon our foreign relations, and to develop such an enlightened public opinion as will enable this great nation to adhere to a constructive policy, which we may all support with pride and with benefit to ourselves as well as to mankind.

THE CASE FOR THE PACT

ARTHUR CAPPER

U. S. Senator from Kansas

I AM very glad that it has been possible—although admittedly not easy—for me to be present with you here and to participate in the discussion of this great theme which engages your interest today. I am especially glad to be able to do this because I think that the time has come for us to recognize that there are questions of public policy and national interest which are in themselves too vast and complex to be solved by the simple operation of the machinery of government in Washington, problems which call for the coöperation of enlightened public opinion and the clarification that comes from expert knowledge placed at the disposal of both citizens and government itself.

Your Academy is rendering a great service to the nation in its dispassionate and scientific analysis of a great proposal for a world treaty to renounce war as an instrument of international policy, a proposal which is shortly to come before the United States Senate for that final act of ratification which would henceforth bind this Republic with the other civilized governments of the world to inaugurate a new era in the dealings of nations with each other. It is not my intention to retrace this evening the details of this discussion; nor is it possible in the brief space of time allotted to me to deal with more than a few outstanding phases of the wide field covered by this renunciation of national wars. What I shall have to say must be from the somewhat narrower standpoint of the Senate itself, to which has been given the duty under the Constitution of scrutinizing the obligations which the country enters into in its treaties with other nations.

The chief purpose of that scrutiny, as I understand it, is to ensure that these treaties do not either controvert the principles of the Constitution itself or betray the interests of the country in the statement and formulation of its policies. It is no secret to us in the Senate that the exercise of this right of

scrutiny has often been attacked by those who have advocated proposals which the Senate has refused to ratify. Each time this has occurred the disappointed proponents have very naturally questioned not merely the wisdom of the senators themselves but the wisdom of the fathers of the Constitution in permitting the Senate to exercise the right of ratification itself. I do not propose to discuss this other question in detail with you, but I cannot forbear, in defense of the body to which I belong, to point out that the principle involved in senatorial ratification is not, as the critics would have us believe, a purely negative and reactionary function of government, but, if properly exercised, the very opposite of that. For its purpose is in harmony with the sanest of all reforms in the field of foreign affairs, namely, the retention and, if possible, the growth and development of popular and representative action in this field. It would be no reform but, on the contrary, a distinct step backward if the almost inconceivable suggestion were carried out that would deprive the legislative branch of the national government of a right to advise with the executive in this regard, for otherwise some executive might conceivably bind the country to policies that ran contrary to the trend of both public opinion and legislative acts. In that case the likelihood of conflicts between the executive and legislative divisions of the government would be increased instead of diminished, for the legislative branch would almost certainly maintain its own prerogatives by the passage of statutes that would tend to nullify any such action of the executive. The solution of the difficulty would seem to lie in an increased rather than a lessened coöperation between the State Department and the Foreign Affairs Committee of the Senate.

A good example of this coöperation may be found in the procedure followed by Secretary Kellogg last winter in the preparation of the Arbitration Treaty which preceded this Pact of Paris, when the Secretary discussed the proposed terms of that Arbitration Treaty in an informal conference with the Senate Committee on Foreign Affairs prior to the negotiation. Without carrying this procedure over into anything resembling Cabinet responsibility, it would seem possible to build upon this precedent, which has many other precedents behind it, and so perhaps through informal action secure ourselves, to some

extent at least, against the danger of presenting to the outside world the appearance of a government that nullifies its own proposals after they have been accepted by other governments.

In any case, it should not be forgotten that it is this process of ratification by the legislative branch of the government which gives a chance for discussion of treaties so far-reaching as that before us; and if there were no senatorial discussions there would be still less chance of bodies like this bringing to the clarification of these issues their contribution of technical knowledge.

Turning now to the treaty before us, I need hardly tell this gathering that in my opinion the Pact of Paris should receive the ready ratification of the United States Senate. From the very first announcement of M. Briand in the spring of 1927, I have advocated our acceptance of the great principles enunciated by the Government of France, principles which are, I believe, not only sound as a basis for practical international policy the world over but are more especially the expression of ideals cherished and developed in our own country. I believe that President Cleveland was right when, forty years ago and more, he stated that it was foreign to the ideals of the American people that they should seek the fulfilment of national ambition or plan the achievement of policy through the killing of men. The wide and continuing popular support which has been given to the Briand proposal shows that this sentiment has been strengthened in all sections of the nation by the tragic experience of the World War.

When the Briand proposal was first advanced, it was a significant fact that, for months following, it continued to be discussed in the press throughout the length and breadth of the land, and with practically unanimous assent to the proposal that the United States could and should take its place alongside the other civilized powers in the great enterprise of eliminating war as an instrument of policy. This body of public opinion is becoming, if anything, more and more alert to the issues now before us and gives an added reality to the treaty text itself. For in matters of this kind it has been well said that the formal acts of government can only register the nation's will and, if the nation is not wholeheartedly behind it, the treaty might prove a hollow mockery in some future hour

of crisis. There is no danger of that happening now, I believe, in connection with the Pact of Paris, for whatever opinions may be held on matters of detail, there can hardly be any doubt but that the nation, as a whole, has registered its popular ratification of the treaty, and also its sincere appreciation of Secretary Kellogg's important part in this great work. And it is a peculiar source of gratification to me to be able to report that perhaps the strongest popular support is coming from that section of the country to which I have the honor to belong. The vast area of the Mississippi basin has at present other things to think about, questions so pressing and policies so vital to its needs, that one might expect the distant problems of the outside world to escape attention there at the present time. But such is not the case. The hope is firmly fixed in the mind and conscience of the Middle West that the United States may at last be on the sure and open path that will lead the world into an era of enduring international peace.

But while there is no doubt that the public opinion of the country will strongly support those policies which make for enduring peace, the responsibility which rests upon the government which attempts to realize this national aspiration is a dual one. It must both provide for peace itself and for the maintenance of those international relations upon which the ordered society of the civilized world rests—relations which in the past have been so largely determined by the instrument of war which it is now proposed to renounce. It must safeguard, on the one hand, the establishment of peace; and on the other hand, it must provide for the continued assurance of the free action of those political forces which make for justice in a constantly changing world. It is when one stops to think of this double aspect which all reforms present to the governments which are responsible for their enactment that one can see the difference between the wholehearted advocacy of unofficial bodies and the caution which so often characterizes the Senate debate. It is not enough for us to agree with the purpose of the Pact of Paris; we must be sure that that purpose is adequately expressed in the documents before us and that it is so framed as not to involve the unsuspecting in hidden commitments.

Now it has already been charged by opponents of the Pact that this is exactly what it does, that this great act of renunci-

ation is illusory and unreal. Indeed it is even claimed that the negotiations accompanying it have involved us in the support of the policies of other nations and the recognition of principles of international law which carry us backward instead of forward, that it calls upon the States adhering to it to renounce an inherent and necessary prerogative of sovereignty. It has been claimed that the sovereign right of freedom to wage war cannot be denied without producing a condition of international anarchy. In short, the argument has been made that the Senate should refuse ratification to the Pact upon the plea that it does not achieve the one supreme purpose which is its aim, that of established international peace under the reign of law.

In stating these objections that have been raised against the Pact, I do not wish for a moment to give the impression that they are widely held or have been seriously entertained by those of us who from the first have been most anxious to see this great reform carried through. So far as I have been able to observe, the objections have come from a relatively small section of the press of the country and from those people who in the past for one reason or another have opposed the movement itself to which the Pact of Paris has given expression. If I call attention to this fact, it is solely to prevent a false impression gaining ground that there is any serious widespread doubt in the country concerning the Pact. That is not the case. On the contrary, it is an astonishing fact that this proposal which reaches so far into the heart of our international relationships has received almost as much approval as to the terms in which it is cast as has been given to the purposes behind it. In addressing myself, therefore, to the objections raised against it, I wish, first of all, to say clearly and emphatically that I do not find them valid.

As to the first objection that the Treaty is not positive enough, that it does not sufficiently provide the machinery of pacific settlement and that it is so vague as to be practically little more than a moral gesture—my answer, in a word, is that the critics have forgotten the fact that last winter the Senate already had ratified the revised arbitration treaty with France which is to serve as a model for other treaties throughout the world extending the existing machinery of pacific settlement. The negotiation of this treaty with other powers than France

is, so the State Department has announced, still in process of fulfilment, and apparently is only held back for the present in order to give the right of way to the Pact of Paris to the end that the arbitration treaties shall in future rest upon the more solid basis of that great act of war renunciation.

But even if we do not bring these arbitration treaties into the argument, I should still be unable to agree with those who claim that the renunciation of war here set forth is a mere rhetorical or empty gesture. On the contrary, it is a most real turning-point in the fundamentals of international dealing. The consequences will not all follow immediately upon the signature or ratification of the treaty, but the treaty does provide a new basis for diplomacy which will be slowly and positively worked out in a growing atmosphere of confidence as the world adjusts itself to the new order of things.

We should not be discouraged if that adjustment takes some time nor should we permit a momentary obstacle to thwart the larger purposes before us. I do not propose to enter into the question of armaments with you at this point, but I would merely say that in the light of recent discussions this treaty gains rather than loses in significance. The full effect of it in this regard will not be evident at once, for it takes time to establish that degree of confidence in the new world order upon which the civilized peoples may hopefully build. But I venture to say that not only is this treaty for the renunciation of war as an instrument of policy a fundamental turning-point in the question of international armaments as a whole, but that in denying the legitimacy of war as an instrument of policy it furnishes the most effective step that can be taken toward the relinquishment of those super-armaments the mere possession of which tempts nations to policies of dangerous adventure. But we must not expect that all the changes inherent in this great reform will be immediately realized, nor must we be discouraged if sometimes the current of events seems temporarily to carry us in another direction. These are but the eddies in the stream, and I need not remind you that the currents which mingle in the great sweep of the tides of public opinion do not all flow peacefully in one direction. Nevertheless, there can be no doubt but that in the deliberate renunciation of war as an instrument of national policy we are taking the most

direct and definite step towards the ultimate elimination of the dangerous race in armaments, by the provision for the elimination of war itself.

There have been two lines of attack on the Pact of Paris. On the one hand, that it amounts to nothing more than a rhetorical statement of good intentions, and, on the other hand, that it binds states to such impotence as will prevent the assertion of their sovereign rights. It goes without saying that it cannot be both of these at one and the same time. As the first objection—that it does not amount to much—is not what could be called a militant objection, we may concentrate our whole attention upon the second point—that it is a disguised but therefore all the more dangerous surrender of the vital interests of a nation to that vague and illusory internationalism which ignores realities, or a surrender to those least idealistic of men, the clever diplomats of professional career.

In plain English the question is whether if we relinquish war as an instrument of national policy we find ourselves relinquishing the only effective instrument of national states to assert the justice of their claims against aggression or attack. The answer to this question lies, I take it, not in the nature of the claims asserted but in the nature of the remedy proposed. As Professor James T. Shotwell has pointed out so forcefully, the one fact which the World War revealed with startling clarity is that war between the great civilized Powers of today is no longer a clearly directable instrument of policy. It is no longer a purely military fact in which victory and defeat follow the movement of battalions or of armies. Those simple days are gone. The nations at war in this industrial era, upon which we have only just entered—and which is becoming more and more industrial with every passing year—do not decide their issues solely upon the battlefields as in the past. The industrial and scientific era of today throws back the strategy of war from armies to factories and mines and the sources of economic supply, and the victory of forces in the field may well turn out to be no more than the sorties of a beleaguered nation forced ultimately to yield by the mere exhaustion of supplies. In other words, war is no longer simply a contest on the field itself; it is the mobilization of all the instruments of destruction which science places at the disposal of mankind,

and those instruments are now so vast, so potent in their power of destruction that, when war is waged between the highly civilized Powers, victor and victim share almost indistinguishably in the common and mutual destruction. In short, war has ceased to be a directable and controllable instrument of policy, and, therefore, the time has come to renounce it as an instrument of policy by all the civilized nations.

But does this mean the stabilization of a world in which injustice still prevails? Does it mean the renunciation of justice itself by refusing to support the cause of the oppressed? Does it mean that we tie our hands with good intentions so as to be impotent to help those who are the victims of oppression elsewhere? There can be but one answer to these questions, and that is that no sovereign state can honor any such engagement; and it follows that no state should assume an engagement which it, in the very nature of the case, cannot honor. We are saved from that predicament by a clause in the preamble of the present Treaty, which, if combined with article 2 of the Treaty, is all-important. It states that "Any Signatory Power which shall hereafter seek to promote its national interests by resort to war should be denied the benefits furnished by this treaty". This clause of the preamble does much more than simply free the signatories from the obligation to remain at peace. It is, if I may say so, the basis of a new world order which draws the distinction between aggression and defense not in the set terms of law but in those directives of policy which when applied furnish in time the categories and distinctions of law.

To see what is meant, let me for a moment contrast this distinction between aggression and defense with the provisions in the Covenant of the League for determining the categories of defense or aggression. There the signatories of the Covenant meet together, or the representatives of a section of them meet in the Council of the League and ascertain whether or not an act of force against any member is an act of aggression or defense. There is no provision of this kind in the treaty before us, but each signatory of the treaty acts independently. Nevertheless, the question which they must raise is not the question of self-interest or of advantage or disadvantage arising from the menace of a conflict; the question is fundamental

ally the same question which the Council of the League must determine, namely, whether an act of aggression has been committed or not. In the case of our treaty each individual state determines for itself the facts in the case, but it should be clear that the question at issue is fundamentally the same in both instances. The signatories of this treaty have as definitely signed away the right to use war as an instrument of their national policy as in the case of the Covenant of the League of Nations, only they reserve it for their individual judgment as to whether the aggression has occurred or not, and which of the combatants is the aggressor.

The reservation which distinguishes this treaty from the Covenant is not a reservation of the right to attack, but a reservation as to who shall be judge in case an attack occurs. The United States has felt, and still feels, that so vital an exercise of sovereignty as this choice involves, should be left to the free prerogative of its own and the other signatory governments. In the case of the League of Nations, it is a prerogative which is, partially at least, open to modifications by the opinion and possibly the urgent statement of a body of states reaching common ground. In this treaty, sovereignty is left its free prerogative of open choice; but once the state has decided that an aggression has occurred, and has a clear mind as to which nation is the aggressor and which the victim, there is provided in this preamble a notification that the binding limitation no longer holds with respect to the aggressor. This is what I should call "the permissive sanction". The United States, for instance, does not engage in a league to put down the aggressor, but it warns the aggressor that it can no longer count on the benevolent friendship of times of peace.

In short, there are embodied in this treaty, even now, the elements of a procedure which will warn any intending aggressor state against the possible consequences. It does not, as in the League, call upon the signatories to redress injustice, but it warns the aggressor that the signatories are free to do so when the aggression is established.

This, I believe, is as far as the United States need consider going at present in the acceptance of an international obligation for the maintenance of peace. But I should take strong issue with those who argue that, because the present treaty does not

definitely call for police action against the aggressor, it therefore does nothing to prevent aggressions. The warning note is there in the recovery of freedom of action against the aggressor state and the definition of aggression is based upon the distinction which I set forth in the proposed Senate Resolution a year ago—that that nation is an aggressor which, having agreed to submit international differences to conciliation, arbitration or judicial settlement, begins hostilities without having done so. The alternatives of “conciliation, arbitration or judicial settlement” are not, it is true, in the text of the present Treaty, but they lie at hand in the accompanying Treaty of Arbitration which France, at least, has already signed and ratified. The two treaties, taken together, make a bond of constructive international dealing which furnish not merely the renunciation of war but the positive structure of pacific settlement.

In short, there is implied in this treaty, especially if bound with the accompanying treaties of conciliation and arbitration, a test to distinguish aggression from legitimate defense, which cannot fail to clarify the whole involved issue that underlies these treaties. And upon that clarification will be built, I firmly believe, a new era, not only of international law but of international policy. We are at last in the paths that lead to enduring international peace, and it is with sincere hope and with the profound conviction that the United States can and should share in this, the greatest turning-point in the history of nations, that I lay before you these points in support of a policy and a measure which at the same time embodies the real purposes and ideals of the people of the United States.

PEACE AND WORLD PROSPERITY

ROY A. YOUNG

Governor, Federal Reserve Bank

IN the eighteenth century Frederick the Great, who knew whereof he spoke, said that there were three things necessary for war: first—money, second—money, and third—money. This statement made more than one hundred years ago is even more completely true at the present time. Changes in methods of doing business, however, have changed the character of money, which was then primarily specie, and now consists largely of bank credit. The fundamental importance of money and, therefore, of banks to the prosecution of wars makes banks carry the chief financial burden of the struggles, and central banks which conduct their business primarily with reference to the public interest feel the strain of war even more than do commercial banks. It is the central bank that supplies to the government whatever currency it may need during periods of war inflation, and central bank reserves in times of war are put at the disposal of the nation and, therefore, become one of the stakes whose fate depends on the fortunes of war.

The terrible experiences of the struggle of 1914-1918 have demonstrated that the soundness of monetary conditions cannot withstand the onslaught of war. Central banks at the present time, therefore, are interested in maintaining peace and for that purpose maintaining international good will. As a matter of fact, coöperation between the central banks rather than mutual jealousy has characterized the post-war period. The United States, for example, has come to the assistance of all the principal central banks when they have undertaken the reconstruction of their currencies, and all the important banks of issue have joined together in supporting the endeavors of smaller countries to reëstablish their currencies on a sound basis. When Belgium stabilized her currency there were fourteen or fifteen central banks that lent their support to the undertaking and the same was true at the time of stabilization in

Italy and in Poland. This coöperation between central banks toward a common end has contributed to the establishment of mutual respect and understanding which will be helpful in finding solutions to international financial problems long before they can develop into causes of misunderstanding or friction, to say nothing of war.

In playing its part in the world's monetary reconstruction, the Federal Reserve System has been placed in a position that has enabled it to render more valuable assistance to other countries than could at this time be rendered by any other central banking system. As a consequence of the war, the United States has forty per cent, or more, of the world's monetary gold stock, and also has larger foreign investments than any other country in the world. In these circumstances, the Federal Reserve System has realized that coöperation with other countries towards the reëstablishment of sound monetary conditions is not merely an act of international comity, but is also essential in the interests of this country itself. Sound money conditions abroad enable American producers to supply the needs of their foreign customers without running the hazards arising from unstable foreign exchanges. They also increase and stabilize the buying power of foreign countries and thus contribute to the ability of these countries to purchase our goods. In these post-war days the United States can no longer remain economically aloof from the affairs of the world. Her foreign trade amounts to close to \$10,000,000,000 a year; her foreign investments aggregate no less than \$25,000,000,000, and her financial and commercial relations with the outside world have become a much greater factor in national prosperity than they were fifteen or twenty years ago. Sound domestic credit policy, therefore, as well as the desire to be of service in world reconstruction, have caused the Federal Reserve System, in formulating its credit policies, to take into consideration the effect that these policies may have on the reëstablishment and maintenance of the international gold standard.

The course of credit developments in the United States since the middle of 1927 illustrates the manner in which foreign conditions may enter into the considerations on which Federal Reserve policy is based and it will be of interest to review

briefly events during this period. In the summer of 1927 credit conditions in Europe were extremely tight. Of the great countries, England, though on the gold standard for over two years, was struggling under the handicap of a serious economic depression; France and Italy had maintained stable the value of their currencies, but had not yet established a definite legal relationship between their monetary units and gold. Autumn was approaching, when foreign countries import the largest volume of American products, and when their exchanges are under the severest pressure for making payments to the United States. It appeared as though it would be impossible for European countries to pass through the period of autumn strain without either losing gold, which they could ill afford, or tightening interest rates, which would further delay the recovery of trade and industry. In the United States trade and industry were showing signs of recession. Commodity prices had been declining for about two years; the temper of the business community was cautious, though the Stock Exchange was active and the volume of credit it employed was large and growing. After carefully canvassing the situation the Federal Reserve System reached the conclusion that its influence should be exerted towards easier money conditions in this country, which would encourage business at home and simultaneously would assist the foreign countries to pass safely through a period which otherwise might endanger the maintenance of the gold standard. Although the System realized that easy money in this country might be an encouragement to further stock-exchange activity, nevertheless it determined that this would be the lesser of two evils and decided to adopt a policy of easing the money market.

In carrying out this plan discount rates at all the twelve Federal Reserve banks were reduced from 4 to $3\frac{1}{2}$ per cent in August and September and the System also purchased a moderate amount of government securities. By thus placing funds at the disposal of member banks the Reserve banks enabled them to reduce their indebtedness at the Reserve banks and to put themselves in a position of granting loans to their customers at relatively low rates. This policy had a good effect on business in the United States and particularly on the volume of agricultural exports. At the same time, it not only

obviated the necessity for foreign countries to ship gold to the United States, but brought about a reversal in the direction of gold movements, so that gold began to move in large volume out of the United States. Owing to the lower rates of interest in this country a part of the financing which would normally have been done in England and on the Continent was done in the United States. Also surplus funds, which always flow to the most profitable market, were moved from the United States to Europe, thus further relieving the tension. Sterling exchange advanced sharply and the Bank of England was able to maintain its discount rate without losing gold.

Gold exports from the United States, which began at that time and in the aggregate amounted to about \$500,000,000, have been an important factor in strengthening the reserve position of European central banks. Italy and France have now legally stabilized their currencies, and financial conditions have been so much strengthened by this autumn that the firm money policy adopted by the Reserve System with reference to domestic conditions has caused no embarrassment to foreign countries.

In the autumn of 1927, when the gold movement first began, the Federal Reserve System, in pursuance of its policy of easier money, purchased government securities to offset the effects of gold exports on the money market, but when the period of greatest strain was passed it discontinued this process and since that time exports of gold have been permitted to exert their influence on credit conditions in this country. Speculation on the Stock Exchange continued, and in view of a rapid expansion of loans on securities with only a moderate demand for credit from trade and industry, the Federal Reserve System not only permitted the gold exports to operate as a tightening influence on credit conditions, but also exerted its influence in other ways toward firmer money conditions. Beginning in January the Reserve banks sold a large amount of government securities, and early in the year began gradually to advance discount rates from $3\frac{1}{2}$ per cent to a level of 5 per cent at eight of the Reserve banks and $4\frac{1}{2}$ per cent at the remaining four banks.

Because of the loss of gold and of the System's firm money policy, together with a growth in the early part of the year

in the volume of bank credit, money conditions became increasingly firm and interest rates in the autumn of this year have been higher than at any time since 1921. These firm conditions in the money market have resulted in discontinuance of the outward gold movement and, in fact, since the middle of the summer there have been imports amounting to over \$50,000,000. The advance in money rates has been felt particularly by dealers in securities, as the call rate has frequently been as high as eight per cent this autumn. The growth in the volume of bank credit, which had been very rapid in the early part of the year, slowed down in the late spring and after considerable fluctuations was not as high in November as in May. The decline has been in the banks' investments and in loans on securities, which include loans to brokers and dealers. Brokers' loans by banks, as distinguished from those by corporations and others, are smaller now than in the middle of May. Commercial loans, on the other hand, continued to increase and the demands of business in connection with autumn trade expansion and the marketing of crops were met by the banks without difficulty. It is true that the cost of credit to industry advanced somewhat, but the advance was much less than the rise in the cost of credit to traders in securities, and the advance in money rates appears not to have had any bad effects on business conditions. Inquiries made by the Federal Reserve Board on this point have brought in replies from all Federal Reserve banks to the effect that business conditions have not been unfavorably affected by higher interest rates, and the latest business reports indicate continued and growing prosperity.

This story of Reserve bank policy during the past year, which I have given in some detail, brings out the manner in which conditions abroad have been taken into consideration in the System's deliberations about its credit policies, and the way these policies have worked out. It shows that conditions abroad have become an important factor in the domestic and credit situation in the United States and as such receive consideration in the formulation of credit policies. The need of keeping informed on foreign conditions has brought about the necessity of broadening the System's sources of information, and for this reason the System has participated in international conferences of business economists. Last spring it sent dele-

gates to a conference of central bank economists held in Paris, and at this moment it is represented at a conference of business statisticians in Geneva.

The conclusion that I have reached during the year that I have been with the Federal Reserve Board is that participation in world affairs is a matter of enlightened self-interest for the United States. I feel confident that a similar attitude towards international coöperation prevails among the authorities of the principal European central banks. The mutual respect and confidence which have developed as a result of joint undertakings by the central banks and the consideration shown by them for each other's problems and difficulties augur well for the maintenance of cordial relations between nations; in other words, peace and world prosperity.

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OF THE
ACADEMY OF POLITICAL SCIENCE

Volume XIII]

JUNE 1929

[Number 3

RAILROAD CONSOLIDATION

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE SEMI-ANNUAL
MEETING OF THE ACADEMY OF POLITICAL SCIENCE
APRIL 24, 1929

EDITED BY
PARKER THOMAS MOON

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THE ACADEMY OF POLITICAL SCIENCE
COLUMBIA UNIVERSITY

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PREFACE

IN accordance with its policy of dealing with such public problems as seem most appropriate for elucidation by responsible and informed discussion, the Academy of Political Science devoted its Semi-Annual Meeting (Forty-ninth Year) to the topic of Railroad Consolidation. The contents of this volume comprise the addresses delivered at that meeting, on April 24, 1929. The importance and timeliness of the topic need scarcely be urged in view of the legislative proposals now pending in Congress, the petitions for railroad unification on the docket of the Interstate Commerce Commission and the lively current discussion of railroad problems in the press. With a transportation system greater than that possessed by any other nation, but with transportation needs which challenge the existing facilities, the United States to-day is facing the problem of acceptance or rejection of proposals designed to carry still further the process of the consolidation of existing railroads into a small number of large systems.

The Academy of Political Science, it goes without saying, is not committed to any proposed solution, nor has it any objective in this matter save the promotion of the public interest by means of intelligent and well-balanced discussion. For the consideration of this topic of Railroad Consolidation the Committee on Program and Arrangements was fortunate in securing as speakers distinguished representatives of different viewpoints and interests. Senator Fess and Congressman Parker are the sponsors of the proposed railroad consolidation legislation in the Senate and in the House respectively. Among the speakers were two former members of the Interstate Commerce Commission, namely, Professor Daniels and Mr. Esch, and the former director-general of railroads, Mr. Walker D. Hines. The viewpoint of the railroads was represented by Mr. Daniel Willard, president of the Baltimore and Ohio Railroad Company, and by Mr. Bird M. Robinson, president of the American Short Line Railroad Association, as well as by lawyers such as Mr. Hines and Mr. J. P. Blair, who have served as counsel for important railroads. The interests of the railroad brotherhoods were set forth by the national legislative representative of the Brotherhood of Railroad

Trainmen, Mr. W. N. Doak. Banking had its representative in Mr. Davis of the National City Company, and the Chamber of Commerce in Mr. Richard Waterman; and finally, Professor Emory R. Johnson, dean of the Wharton School of Finance and Commerce, Professor Seligman of Columbia University and Professor Daniels of Yale University contributed to the discussion as economists.

The program of the meeting was so arranged that in the Morning Session the discussion was focused upon the extent, methods and problems of railroad unification prior to the enactment of the Transportation Act of 1920 and during the nine subsequent years. In the Afternoon Session the speakers dealt with the advantages and disadvantages of consolidation, and in the Evening Session attention was given to the railroad consolidation bills now pending in Congress and to the notable transformations that have occurred in the public attitude toward the combination of transportation agencies. All three sessions were held on the campus of Columbia University, and the speakers met together at luncheon in the Men's Faculty Club and again at dinner in the Yacht Room of the Hotel Astor. The program of the meeting in detail was as follows:

PROGRAM

FIRST SESSION

Wednesday, April 24, 1929, 10 A. M.

McMillin Theatre, Columbia University

TOPIC: Unification under the Present Law

WALKER D. HINES, *Presiding*

1. *The Public Interest in Railroad Unification and Consolidation.* WALKER D. HINES.
2. *Processes and Results of Railroad Unification.* J. P. BLAIR.
3. *The Effect of Railroad Consolidations on Railroad Securities.* PIERPONT V. DAVIS.
4. *Obstacles to Railroad Consolidation in Eastern Territory.* EMORY R. JOHNSON.
5. *The Progress of Unification.* RICHARD WATERMAN.
6. *Discussion.*

SECOND SESSION

Wednesday, April 24, 2:30 P. M.

McMillin Theatre, Columbia University

***TOPIC: Advantages and Disadvantages of
Consolidation***

JOHN J. ESCH, *Presiding*

1. *Advantages and Disadvantages of Consolidation.* JOHN J. ESCH.
2. *Interest of Shippers and Farmers in Railroad Consolidation.* HONORABLE JAMES S. PARKER.
3. *Consolidation from the Railroad Employees' Viewpoint.* W. N. DOAK.
4. *The Relation of the Short Lines to Railroad Consolidation.* BIRD M. ROBINSON.
5. *Consolidation and Equalization.* GEORGE G. REYNOLDS.

THIRD SESSION

Wednesday, April 24, 1929, 8:15 P. M.

Horace Mann Auditorium, Columbia University

TOPIC: Pending Consolidation Legislation

PROFESSOR EDWIN R. A. SELIGMAN, *Presiding*

1. *Competition and Railroad Consolidation.* EDWIN R. A. SELIGMAN.
2. *The Changing Attitude of Public Policy toward Railroad Consolidation.* WINTHROP M. DANIELS.
3. *The Proposed Railroad Consolidation Act of 1929.* HONORABLE SIMEON D. FESS.
4. *The Status of Railroad Consolidation.* DANIEL WILLARD.

For the convenience of readers there follows a brief "Who's Who" of the speakers who contributed to the program and whose addresses are published in this volume.

J. P. BLAIR, who addressed the Morning Session on the "Processes and Results of Railroad Unification", was able to

draw upon a wealth of practical experience as general counsel of the Southern Pacific Company since 1913.

WINTHROP M. DANIELS was professor of political economy at Princeton from 1892 to 1911, when he became a member of the Board of Public Utility Commissioners of New Jersey. In 1914 he was appointed to the Interstate Commerce Commission, of which he became chairman in 1918, and from which he resigned in 1923. From the latter date he has been professor of transportation at Yale University.

PIERPONT V. DAVIS, whose illuminating discussion of "The Effect of Railroad Consolidations on Railroad Securities" was a feature of the Morning Session, is vice-president of the National City Company of New York. Formerly chairman of the Railroad Securities Committee of the Investment Bankers Association (1921-22) and director of a number of railroads, Mr. Davis is now a member of the Railroad Committee of the Chamber of Commerce of the United States and a director of the Philadelphia and Reading Coal and Iron Corporation. He has recently been elected president of the Bond Club of New York.

W. N. DOAK, who dealt with "Consolidation from the Railroad Employees' Viewpoint", is the national legislative representative of the Brotherhood of Railroad Trainmen and editor and manager of the Brotherhood organ, *The Railroad Trainman*. It will be recalled that Mr. Doak's name was frequently spoken of in connection with the post of Secretary of Labor before it was decided that the present incumbent of that office should continue in charge of the department.

JOHN J. ESCH is known throughout the United States for his conspicuous part in the deliberations of Congress from 1899 to 1921. Having been a member of the Interstate Commerce Commission from 1921 to 1928, he brings to the discussion of railroad consolidation an intimate acquaintance with the problems both of consolidation and of regulation.

SIMEON D. FESS, United States senator from Ohio since 1923, entered public life after a distinguished academic career. He served as professor of American history, head of the col-

lege of law and vice-president of Ohio Northern University, then as lecturer in the University of Chicago, and as president of Antioch College from 1907 to 1917. He was elected to the Sixty-third Congress in 1913 and reelected to the four succeeding Congresses, meanwhile serving as chairman of the Republican National Congressional Campaign Committee in 1918, 1920 and 1922. He has sponsored the bill now before the Senate for the amendment of our federal legislation on railroad consolidation.

WALKER D. HINES, who presided at the Morning Session, has been a member of the law firm of Hines, Rearick, Door, Travis and Marshall since 1927 and is also president of the Cotton Textile Institute and a director of the Chicago, Burlington and Quincy Railroad. In 1920-21 he served as arbitrator under the Peace Treaties on questions of river shipping in Europe, and in 1925 he made an investigation and report on the navigation of the Rhine and Danube rivers for the League of Nations. His experience in the field of railway management and regulation has extended over a long period of years. He has acted as assistant chief attorney for the Louisville and Nashville Railroad and as general counsel for the Atchison, Topeka and Santa Fe Railroad. He served as chairman of the executive committee of the Atchison, Topeka and Santa Fe Railroad from 1908 to 1916 and then as chairman of the board of directors of the same company until 1918, when he accepted the post under the United States government of assistant director-general of railways from 1918 to 1919 and director-general from 1919 to 1920.

EMORY R. JOHNSON has been professor of transportation and commerce at the University of Pennsylvania since 1896 and dean of the Wharton School of Finance and Commerce since 1919. As a transportation specialist he has served as adviser to the United States Industrial Commission in 1899; as member of the United States Isthmian Canal Commission, 1899-1904; as expert on the valuation of railway property, United States Census Bureau; as expert on traffic, National Waterways Commission, 1909; as investigator appointed by President Taft to report on Panama Canal traffic; as director of the Philadelphia Maritime Exchange; as member of the Public Service

Commission of Pennsylvania, 1913-15; as arbitrator of a dispute between the Southern Pacific Company and the Order of Railroad Telegraphers, 1907; as assistant director of the Bureau of Transportation of the War Trade Board; as rate expert for the United States Shipping Board, 1918-19; as transportation expert for the United States Chamber of Commerce, 1919-21, 1923, 1925. Among his numerous writings on transportation topics the following should be mentioned: *Inland Waterways, Their Relation to Transportation*; *American Railway Transportation*; *Ocean and Inland Water Transportation*; *Elements of Transportation*; *Railroad Traffic and Rates*; *Panama Canal Traffic and Tolls*; *Measurement of Vessels for the Panama Canal*; *History of Domestic and Foreign Commerce of the United States*; *The Panama Canal and Commerce*; *Principles of Ocean Transportation*.

JAMES S. PARKER, who spoke on the "Interest of Shippers and Farmers in Railroad Consolidation", has been a member of Congress since 1913 and represents the twenty-ninth district of New York. As sponsor of the Parker Bill which was considered in the last Congress and has recently been reintroduced in the present Congress, he gave his reasons, at the Afternoon Session, for supporting the measure with which his name is generally coupled.

GEORGE G. REYNOLDS, a graduate of Harvard Law School, has practised at the bar of New York since 1908. He holds the degree of Ph.D. from Columbia University and is the author of a monograph entitled *The Distribution of Power to Regulate Interstate Carriers between the Nation and the States*. He served with the United States Railway Administration in 1919 and 1920.

BIRD M. ROBINSON, who spoke at the second session on "The Relation of the Short Lines to Railroad Consolidation", is president of the American Short Line Railroad Association and has been conspicuously influential in securing greater consideration for the short lines in connection with the expansion or unification of larger systems.

EDWIN R. A. SELIGMAN, McVickar Professor of Political Economy at Columbia University and editor of the *Encyclopedia of the Social Sciences*, is so well known to members of the Academy of Political Science that it is hardly necessary here to enumerate his writings and his achievements.

RICHARD WATERMAN of the Railroad Bureau of the United States Chamber of Commerce spoke on "The Progress of Consolidation" at the Morning Session, and displayed the very interesting chart and statistical table prepared by the Bureau and reproduced in this volume. In addition he has prepared for this volume a list of the several constituent companies comprised in the leading railroad systems of the country.

DANIEL WILLARD entered upon his career in railroad service in 1879, was assistant general manager of the Baltimore and Ohio from 1899 to 1901, then served successively as assistant to the president, as third vice-president, as first vice-president and as general manager of the Erie Railroad. Subsequently he became second vice-president of the Chicago, Burlington and Quincy Railroad, president of the Colorado Midland Railway Company and vice-president of the Colorado and Southern Railway Company. Since 1910 he has been president of the Baltimore and Ohio. He is a director of numerous companies, including American Telephone and Telegraph Company and the Union Trust Company. A trustee of Johns Hopkins University, he has been president of the board of trustees since 1926. During the war he was appointed a member of the Advisory Commission of the Council of National Defense, and became its chairman in 1917; and in 1917-18 he was chairman of the War Industries Board.

The officers of the Academy wish to express their gratitude to the busy executives and distinguished experts who participated in the meeting and contributed to this volume. The Academy owes and gives thanks to the members of the Committee on Program and Arrangements, who contributed so generously of their time and knowledge to make the meeting a success. The membership of the committee was as follows:

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PART I
UNIFICATION UNDER THE
PRESENT LAW

THE PUBLIC INTEREST IN RAILROAD UNIFICATION AND CONSOLIDATION¹

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A PARTICULARLY interesting feature of the problem of railroad unification and consolidation is the extraordinary reversal of policy toward railroad combines which took place when the Transportation Act was passed by Congress in 1920. Up to that time, at least since 1890, the conception underlying our legislation had been that any form of railroad combination which might have a tendency to interfere with any substantial competition was contrary to the public interest and was prohibited. When the Interstate Commerce Act was originally passed in 1887, the matter of consolidation or unification of different railroads was not dealt with, but the act did prohibit any form of pooling of traffic or earnings, thus seeking to prevent any interference with the most active competition.

In 1890 the Anti-Trust Act was passed, prohibiting restraints of trade or commerce. For a long time it was very generally believed that this act did not apply to railroads at all, because they were regulated by the Interstate Commerce Act, and the language of the Anti-Trust Act did not necessarily apply to the railroads. This question came up in the *Trans-Missouri* case and the *Joint Traffic Association* case, both of which arose out of traffic agreements among different railroads to stabilize their rates and to maintain reasonable rates. No element of railroad consolidation was involved, but the traffic agreements did involve the possibility of interference with the most unrestricted competition. The trial court and the circuit court of appeals both held that the Anti-Trust Act did not prohibit arrangements of that sort among railroads. When the cases got to the Supreme Court, the railroad world and, I believe, the legal profession were rather taken by sur-

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prise when the Supreme Court held that the Anti-Trust Act *did* apply to railroads and *did* prohibit any form of combination which put any appreciable restriction on the most unlimited railroad competition.

From that time, under the old law, the railroads were restricted by the Interstate Commerce Act as to pooling, and by the Anti-Trust Act as to other agreements and as to railroad combinations; not only agreements among railroads to maintain rates, but acquisitions of one railroad by another, were regarded as prohibited by that act, if substantial competition could be regarded as thereby eliminated.

The earlier instances in which the Supreme Court applied this doctrine were cases in which two railroads, very actively in competition, attempted to combine. The Supreme Court held that this was prohibited by the Anti-Trust Act.

But the doctrine of the Supreme Court developed to the point where, a few years later, a more extreme position was taken in the famous Harriman case, which involved an attack by the government on the Union Pacific. The latter had acquired control of the Southern Pacific through getting not a majority of the stock but such a very substantial interest in the stock as to give it effective control of the Southern Pacific. Although to a very large extent the relationship of the Union Pacific and Southern Pacific was complementary rather than competitive, the Supreme Court held that there was substantial competition and that despite the complementary aspects of the two systems, the vesting of them in any form of single financial control was prohibited by the Anti-Trust Act.

The Supreme Court went farther a few years later in a case where there was involved the question whether the Southern Pacific control of the Central Pacific violated the Anti-Trust Act. The two roads had been developed together, apparently, as a part of a policy of the government to encourage a definite relationship between them. The Southern Pacific, extending through Northern and Southern California and then down to El Paso, Texas, and on to New Orleans, had for many years held the Central Pacific, which extended from the neighborhood of San Francisco directly east to Ogden and Salt Lake City. Undoubtedly, the primary relationship between those two systems was complementary, because a great deal of the

traffic moving on the Southern Pacific to or from California points could not conveniently move south by the El Paso gateway, but naturally moved east or west by the Central Pacific to Ogden and connected there with the Union Pacific. The legal profession and the railroad world were taken by surprise when the Supreme Court ruled even in that case, where the competitive element was very small and the complementary aspect was very predominant, that there was a violation of the Anti-Trust Act in the Southern Pacific's controlling the Central Pacific.

Along with the very rigid development of the Anti-Trust Act by the Supreme Court, there had arisen an increasing belief even before the war that the legislation with respect to the railroads was altogether restrictive and in no sense promotive of a better railroad status. The whole theory in all the legislation (including the anti-trust legislation) as applied to railroads seems to have been that the railroads would always be able to take care of themselves and that the only thing the government needed to concern itself about was to prohibit the railroads from doing anything which by any conceivable theory might be regarded as injuring the public interest. Consequently the legislation was purely restrictive, purely repressive. The railroads did not thrive under that conception of regulation, and prior to our entry into the war railroad conditions seemed so disturbing and so unpromising for the future, and the railroads seemed to experience such difficulty in raising sufficient capital to improve their systems so as to keep abreast of the demands of the public, that a joint committee of the House and Senate was created to investigate the general railroad situation. That committee was created as a result of a suggestion by President Wilson, and was known as the Newlands Committee. It was actively at work when we entered the war, but its work was interfered with by the government's taking over the operation of the railroads for war purposes during the year 1918, and by the government's then holding the railroads until Congress could revise its legislation with respect to them. When Congress did that and passed the Transportation Act of 1920, it completely reversed the earlier policy which prohibited any form of railroad combination involving any suppression of appreciable competition.

Instead, the Transportation Act authorized the Interstate Commerce Commission to permit pooling between different railroads when it was regarded as in the public interest, and further, the act adopted rather an elaborate plan for authorizing voluntary railroad combinations.

I doubt if we can find in the legislative history of our federal government a more striking instance of complete reversal of policy. From a policy of practically unrestrained and unqualified interference with anything in the nature of rail combination where an element of competition might be involved, the government turned around to a plan which affirmatively provided for all forms of rail combination when approved by the Interstate Commerce Commission as being in the public interest.

This Transportation Act of 1920 is really the basis of the present discussion. I think it is important to bear in mind that the act provided for two completely distinct sorts of railroad combination, each of which might be authorized under certain conditions when the Interstate Commerce Commission should decide that the particular arrangement would be in the public interest. Of course, nothing was authorized except when the commission approved it as in the public interest, and until approved by the commission any combination interfering with competition would still be a violation of the Anti-Trust Act and also, in many instances, of various state acts; but the Transportation Act made affirmative provision for rail combination through voluntary action of the railroads and provided that when the commission had approved a plan of that sort, thereafter the railroads involved, when carrying out that plan, would be protected from the prohibitions of the federal Anti-Trust Act, and also from the prohibitions of any state legislation of a similar character.

As I said, the Transportation Act provided for rail combinations of two distinct sorts, one ordinarily thought of and spoken of as consolidation, and so described in the act, and the other quite frequently spoken of as unification.

The consolidation that was provided for by the Transportation Act was a complete consolidation of two or more railroads in such a way that the legal ownership of the properties would be vested in a single corporation, and that corporation then

would not only directly own the properties, but, of course, as a result would have the complete power to operate them as a single system. However, this form of consolidation was accompanied by rather an elaborate procedure. The Interstate Commerce Commission has construed that procedure as having the effect of not authorizing such a complete consolidation of both ownership and operation until the commission makes a general plan for consolidating all the railroads in the United States into a limited number of systems, and then the theory is that the commission has the power to authorize any particular plan of consolidation that is voluntarily brought before it by the carriers interested, provided it is in accordance with the commission's general plan. The commission is authorized to change that general plan from time to time, but the commission's view is that the framing of such a plan must necessarily precede authority for these complete consolidations. Although it is nine years since the Transportation Act was passed, the commission has found it very difficult, and so far impracticable, to announce a final general consolidation plan for the country. As a result, no consolidations in this complete sense of both legal ownership and operation by a single corporation have so far been permitted by the commission.

On the other hand, the second method of railroad combination provided for in the Transportation Act, by means of control through stock ownership or lease or other method falling short of complete consolidation, has been resorted to from the outset without the necessity for any such elaborate procedure, and has been repeatedly authorized by the commission in the period since the passage of the act. I gather from the reports of the Interstate Commerce Commission that the commission has sanctioned the taking of control of something over 42,000 miles of railroad by other carriers. To a very large extent, in these cases, the carrier seeking to take control of another railroad through stock ownership already had an important control over that railroad. For example, the former railroad company may, for many years, have owned the stock of the other railroad, and it may have applied for authority to take a lease of the other railroad in addition. The former railroad may have owned virtually a majority of the stock, but not an absolute majority, and it may have applied for that.

Thus in the 42,000 miles I speak of, there were many cases where the railroads involved were already affiliated and where the action of the commission did not set up a new condition of combination that had theretofore not existed.

There have, however, been some very important cases where the commission has authorized the unifications which are provided for in the Transportation Act. It has done so in cases where prior to the commission's act there was no control of the one carrier by the other, that is, no effective control either through owning a majority of the stock, through lease or through other arrangement. There have been about 17,000 miles involved in instances of that character where the common control originated with the commission's action. Among the important instances was the commission's authorization of the direct and indirect control by the Missouri Pacific of the International and Great Northern, the Gulf Coast Lines and the Texas and Pacific, amounting to about 3,800 miles of line. The commission has authorized the Chesapeake and Ohio to take control of the Pere Marquette, the latter having about 2,280 miles of road. The commission has authorized the Southern Pacific to take control of the El Paso and Southwestern, the latter having about 1,500 miles of road. The commission has authorized the Atchison, Topeka and Santa Fe to take control of the Kansas City, Mexico and Orient, the latter having about 740 miles of railroad. These instances are very substantial; they indicate an important movement on the part of the commission in going forward with rail unifications even in advance of making the general plan for complete consolidation, which has been so beset with difficulties that the commission has not yet been able to effect it.

This method of unification of control through stock control or lease is fundamentally distinct from the method of consolidation by vesting the legal title of the combined railroads in a single corporation. The matters are dealt with separately in the Transportation Act. Separate phraseology is employed and there is a very clear reason for the difference which Congress has applied in the treatment of these methods.

The unification through stock control or lease stops short of that condition which would be created by a complete consolidation, because where there is a mere unification through stock

control or lease, the legal title to each railroad remains in its own separate corporation. While the stock of that corporation may be vested in the acquiring carrier, or the right to operate may be vested in the acquiring carrier through a lease of the railroad in question, nevertheless the legal ownership remains in the original corporation, and therefore is in a situation that is less final and may be dealt with by the commission if it wishes to reserve the matter for future consideration.

The difference between what may happen under a control through stock ownership, for example, and what may happen under complete consolidation, is shown by what did happen in the case where the Union Pacific acquired control of the Southern Pacific through having a very large and effective minority of the stock. As I pointed out, that control actually existed for a number of years. The operation of those two carriers was unified under a single direction and the common control was regarded as very effective, but to the surprise of a good many people the Supreme Court held that such control violated the Anti-Trust Act.

When that was decided, inasmuch as the Southern Pacific's corporate entity still existed, it was reasonably feasible to compel the Union Pacific to give up its Southern Pacific stock, and the two corporations could then resume their independent activities. In a similar way under the Transportation Act the commission, in authorizing one of these unifications through stock ownership or lease, may reserve a condition enabling it to undo the unification if it sees fit when it comes eventually to deal with the matter of consolidation. The commission in some cases has made an express reservation of this sort.

I think that it was very wise on the part of Congress to do what it so plainly indicated its purpose to do, namely, to provide for these two different forms of rail combination. Everything that is done has to be done by voluntary action, and if all voluntary action must await the commission's consolidation plan for the whole country and then wait until carriers work out voluntary plans along the lines of that general plan, the prospect of early action is very slight. On the contrary, where any particular plan voluntarily worked out for control of one carrier by another through stock ownership and unification is brought forward and the commission feels that it is in

the public interest, that matter can be proceeded with and progress can be made in the direction of rail combination.

I think the constructive action which the commission has taken in authorizing the various unifications through stock control or lease has been very much in the public interest, because it means working out by degrees a plan which in any event must take a great deal of time, and which can proceed only when there is a voluntary desire on the part of the different railroads involved in a particular plan to put it together and submit it to the commission and carry it out if the commission desires and deems it in the public interest.

Just a few words on what seem to me some of the most important reasons for rail combination. For one thing, I believe it will greatly facilitate the administration of federal regulation. If we could visualize what the situation would have been if all the different railroad systems in this country were still in their original status, that is to say, if in place of each of the big systems there were fifty or a hundred or more separate railroad companies operating little sections of line, we could see that the progress that had been made toward the development of large railroad systems prior to the repressive construction that was given to the Anti-Trust Act was very much in the public interest from the standpoint of regulation, for it is much simpler for the commission to regulate the fifty, sixty or seventy systems of substantial size which we now have in this country than to regulate several thousands, dividing up the traffic and the operation of the existing systems which now control most of the business. I think, likewise, it would be still further in the public interest from the standpoint of railroad administration if the number of systems were reduced, as I hope it will be eventually, to ten, twelve, or fifteen—something like that. I believe the problems of railroad administration will be vastly simplified by that progress.

In this connection, the situation of the numerous short line railroads must be considered. The Interstate Commerce Commission attaches great importance to bringing them into the larger systems. That aim may be achieved through these processes of rail combination, and its achievement will simplify the regulation and be in the public interest.

Moreover, the economies to be obtained from reasonable

railroad combination are very important. Analysis will show that the opportunities for saving money are more important than they are frequently thought to be. In the long run, the more money a railroad can make on a given scale of rates, the better the prospect for readjusting those rates in the future in the public interest. Beyond that, I believe the railroads of this country are confronted with a very difficult situation due to the shifting of the traffic. So much of the passenger traffic has already gone to automobiles. A good deal of the freight traffic has already gone to auto trucks. There are fundamental changes taking place. If the railroads are to continue to give the extraordinarily good service which they are now giving and if they are to do so without having to increase the rates, which the public would prefer to avoid, then it is necessary for them to find new economies.

I believe the most hopeful way of effecting important economies is through promoting rail combination, first, through the separate plan of unification which is now available, and second, eventually, through working out a more complete scheme of consolidation. Of course, if the plans of unification are carried forward as opportunities arise through the voluntary plans of the railroads, it will greatly simplify the ultimate consolidation.

The fear has been expressed that combination of railroads into larger systems would affect competition unfavorably. I want to say a word as to my view about that. I think I can illustrate it best by referring to the evolution of my own ideas about it. During federal control of railroads I became very much impressed with the view that public interest would be promoted by consolidating the railroads into a comparatively small number of systems. My first thought was that this could best be done by a few regional systems. For example, in the territory east of the Mississippi, north of the Ohio and Potomac, there might be two to four great systems. In the territory west of the Mississippi, there might be three or four or five great systems. In the territory south of the Ohio and Potomac, there might be two or three systems. These could be regarded as regional systems, and therefore the stress would not be on competition.

When, however, I came to analyze the situation further, I realized that no matter how much you tried to keep a particular

consolidated railroad system in one geographical part of the country, there would be the most intense competition between it and the other great systems. In the East, for example, if there were only two systems, one built on the New York Central and the other on the Pennsylvania, I do not see how you could imagine a greater degree of competition than would thereby exist. And if three or four systems were developed instead of two, there would likewise be far-reaching competition. The same thing would be true in the South. If one system were based on the Louisville and Nashville and the Atlantic Coast Lines, and the other were based on the Southern Railway, however you arranged those systems you would have most intense competition. Competition in the South would be made more effective, rather than less effective, by consolidating the activities of the railroads into a few systems. Likewise in the West, if three or four systems were made, one in the northern tier of states, one in the central tier and one in the southern tier, the competition among these roads would be so intense as to dominate standards of service and rates.

The conditions I have just pointed out were what led me to believe, when I was analyzing this matter during the federal control of the railroads, that even the strictest practicable application of the theory of regional systems would still leave the country provided with ample competition of the most intensive character. Since the public was disposed to assume that a regional plan contemplated the elimination of competitive systems, and since there could be no such elimination in fact, I felt that there was no point in creating a misleading conception by proposing a plan of regional systems, and that the language employed would be more accurate if the consolidated systems were spoken of as competitive and emphasis placed on the competitive aspect.

In my judgment the policy of consolidation need not arouse any fears that there will not remain ample competition, because I would defy anybody to arrange the railroads of this country in a few large systems among which there would not be the most effective and far-reaching competition, competition of a salutary character which at the same time would eliminate some purely wasteful duplications of service.

PROCESSES AND RESULTS OF RAILROAD UNIFICATION

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THE subject assigned to me on the program for this morning's session differs somewhat from the topic I undertook to discuss when I accepted the invitation, by which I was honored, to participate in to-day's proceedings. The words of the invitation were that I should "take part in the discussion of the 'Results of Unification in Individual Cases' by presenting a brief statement dealing with experiences of the Southern Pacific System." As unifications are to be the order of the day, I propose to effect a unification of the two topics, and to speak to you about "Results of Unification", as illustrated by the experiences of the Southern Pacific system. Under the rules of the Interstate Commerce Commission it is incumbent upon the proponent to give justifying reasons for any proposed unification. I shall now comply with that rule.

The list of topics on the program shows that it is the object of the present session to have the matter of railway unification presented and discussed in its many different aspects, beginning with the state of the law as it now is and ending with the amendatory and supplementary legislation required to correct the now universally recognized defects and shortcomings of the present law—legislation which Congress has been considering for four or five years with exasperating slowness. The purpose, I take it, of placing at the head of the list the subject of the results of unification is to have presented to you first the pertinent provisions of the present law and what has been accomplished under them. I have thought that the best way to show the nature and scope of the law and the results of its operation is to follow the case system of instruction, that is, to select concrete examples of unifications that will illustrate both the purposes of the law and the extent to which they have been realized in its actual administration. Naturally I have selected the experiences of the Southern Pacific Company,

where I shall be on familiar ground and can speak *ex cathedra*. I shall deal only with purposes and results within the admitted scope and contemplation of the law. If I attempted to discuss cases involving controversies over the meaning of the law or the jurisdiction of the Interstate Commerce Commission, I should run the double risk of boring you and of encroaching upon the time as well as the subject matter of other speakers.

Of course the unifications to be considered, as we are to deal with results of unification, must be those provided for in the unification provisions, or so-called "consolidation" provisions, of the Transportation Act of 1920. Those provisions have been interpolated into the Interstate Commerce Act and are now found in certain numbered paragraphs of Section 5 of that act. The unifications so provided for are: first, a union of the earnings or traffic of two or more railroads through a pooling agreement, when approved and authorized by the Interstate Commerce Commission as in the public interest; second, a control by one railroad over another through the acquisition, when likewise approved and authorized by the commission, of a controlling amount of the stock or through a lease of the properties of another railroad or in some other manner short of consolidation; and finally, the consolidation of two or more carrier corporations into a single corporation. The first and third species of unification are eliminated from this discussion because there have been no authorized pooling agreements that call for present consideration and because consolidation under the act is not permitted until after the commission has completed and promulgated a final plan for the consolidation of the railroads of the country into a limited number of enlarged systems, a task it has not yet been able to accomplish. This leaves for discussion unification to be brought about by the acquisition by one railroad, in some one or more of the authorized ways, of control over another. This kind of unification is provided for in what is now paragraph 2 of Section 5 of the Interstate Commerce Act, and for our present purposes it may be described as unification by common control.

The purpose and practical effect of paragraph 2 is to provide a means whereby one railroad may lawfully acquire control of another, by purchase of a controlling amount of the

stock of the other company or by lease of its properties, or in some other manner not amounting to an actual consolidation, notwithstanding the fact that such acquisition of control may be in violation of some anti-trust law ; provided the commission finds after investigation, made on application of the railroad desiring to acquire control of another, that the proposed acquisition is in the public interest.

When such an application is filed with the commission notice thereof is given to the governors and public service commissions of the states in which the railroads concerned are located. Opportunity is afforded to any one who is interested or thinks he is interested to intervene and support or approve the application. A hearing is had, testimony taken and arguments presented. Then the commission weighs the advantages to the public, frequently in the form of more economical and efficient operation, against the disadvantages, frequently in the form of some lessening of existing competition which would bring the unification within the condemnation of the anti-trust laws. If in its opinion the advantages preponderate, it approves and authorizes the proposed acquisition. The outcome is one form of unification, that which results from the common control of two or more corporations. If the control results from stock ownership it is exercised through common officers. If in the form of a lease it is exercised by the lessee company's taking possession of the leased properties and operating them in union with its own properties. Under another paragraph of Section 5, paragraph 8, the commission's order of approval completely immunizes the railroads concerned from the restraints and prohibitions of all anti-trust laws, or any other law, state or federal, so far as may be necessary to accomplish what the commission has authorized.

Let me call your attention here to the important significance of this paragraph 8. It constitutes a radical departure from the old régime of the inflexible, implacable application to railroads of all anti-trust laws, state and federal. It marks the inauguration of a new public policy, based on the belief of Congress that there may be combinations of railroads that are within the condemnation of the anti-trust laws and at the same time in the public interest. It provides for the sweeping aside of such laws when in the path of a unification of railroads, in

the form of a pool or common control or consolidation, which the commission shall have found to be in the public interest. It is a great tribute to the commission that the people of this country, through their representatives in Congress, should have been willing to rely upon the judgment and discretion of the commission instead of on the bars of restrictive legislation to protect them from combinations of competing railroads so long regarded by them as unalloyed evils.

It has doubtless occurred to you that by reason of paragraph 8 the railroads have a more advantageous position in respect to the anti-trust laws than, for example, the oil industry, whose recent efforts to protect our oil supply from wasteful overproduction, although generally commended, have just had a fatal collision with the Sherman Law. But it must be remembered that with a great price the railroads have bought this advantage, that is, by subjection to the very broad and the very detailed supervision, regulation and control of the Interstate Commerce Commission. Without such supervisory powers in the commission Congress would not, and should not, have provided the conditional exemption from the anti-trust laws found in the Transportation Act.

You will observe that I say "conditional exemption". We must not make the mistake which some railroads seem to have made in the recent past, to their present great discomfiture, of supposing that the railroads are now emancipated from the restrictions of the Sherman Law and similar statutes. The machinery which paragraph 8 provides for sweeping away the anti-trust acts when they interfere with the consummation of a desirable unification does not begin to operate unless and until the commission presses the button.

What I have just been saying about paragraph 8 is illustrated by the first experience of the Southern Pacific Company under paragraph 2 of Section 5, when it fled for its life to the Transportation Act as a city of refuge and reached it just in time to escape death at the hands of the pursuing Sherman Law. I refer to the application to the commission under which the Southern Pacific Company acquired or rather reacquired control of the Central Pacific Railroad Company.

In 1922 the Supreme Court of the United States, to our consternation and, I may say, to our amazement, declared that

the common control of the Central Pacific Railway Company and the Southern Pacific Railroad Company, which had existed for fifty years or more, was in violation of the Sherman Law, and ordered the immediate termination thereof.¹

In order that you may realize what is meant by the rigid, implacable application to railroads of the anti-trust laws it is necessary for me to describe the character of the system of railroads which the Supreme Court, under compulsion of the Sherman Law, decreed should be dissolved. The Central Pacific lines and the Southern Pacific Railroad lines had always been under a common control. Beginning about 1870 the two sets of lines had developed together as a single interdependent system. Born of a common parentage and fed from a common tap, they were intended and expected always to be mutually dependent members of the same family. You can therefore readily understand that their separation into two parts would have resulted not in two self-sufficient systems, but in two maimed and incomplete parts of what had been a single system. The dismemberment which the court directed to be made was in reality a capital operation, likely to be fatal not only to the Southern Pacific system, but to the transportation needs of the communities served by the system.

From the death sentence that had been pronounced by the Supreme Court the Southern Pacific Company fled for refuge to the Transportation Act and prostrated itself before the altar it found in paragraph 2 of Section 5. We applied to the commission to legalize, in the exercise of its powers under the Transportation Act, the common control which the Supreme Court had declared unlawful under the Sherman Law. In this application we were actively assisted by the several states and communities in which our system lines were located. Their consternation over the decree of dismemberment rivaled ours, since they saw that it meant a mutilation of the transportation machine upon which they were very dependent and the constitution of which they had never complained of. The commission had no difficulty in finding as a fact that the common control was in the public interest; that the benefits of any competition that might be gained by the dismemberment of the system were as nothing compared to the benefits from the continued opera-

¹ 259 U. S. 214.

tion of the lines concerned as one system. It had the courage as well as the good sense to render an order approving and authorizing the common control, which was in the form of stock ownership and operation under leases by the Southern Pacific Company of both sets of lines.¹

Armed with this order of the commission we appeared before the lower court to which the Supreme Court's mandate was directed. There we were met by the solicitor general with a drastic decree of dismemberment drafted pursuant to the mandate.

To make a long story short the lower court had also the intelligence and the courage to recognize that the order of the commission under the later act of Congress superseded the decree of the court under the earlier Sherman Law; and the final decree adopted and confirmed the commission's order.² Thus the country was saved, including the Southern Pacific system.

The radical difference between the new and the old régime may be stated in a sentence. The underlying philosophy of the new dispensation is that the public interest in any particular case should prevail over the prohibitions of general laws, while the dominant maxim of the old dispensation is, let competition be unrestrained though the heavens fall — *floreat competitio, ruat coelum*.

Having seen the beneficial operation of the provisions of paragraph 8 upon federal anti-trust acts, let us now consider their effect upon similar state laws. For this purpose I have selected for brief mention two experiences of the Southern Pacific Company. One shows that the apprehension and even hostility which some of the states and many communities felt at first towards the novel power given the commission in paragraph 8 to supersede state laws gradually subsided as the results of the exercise of the power became generally known. The other is an instance of an unexpected but frequently occurring result in the course of the administration of the law, that is, a willing dependence by the states upon the commission's powers for relief from the excessive restrictions of their own laws, when such restrictions block the way to a desirable unification of local railroads. In other words the

¹ 76 I. C. C. 508.

² 290 F. R. 443.

states instead of repealing or modifying the outmoded restrictions of their own laws have come to look to the federal statute for relief.

It will be very persuasive evidence both of the wisdom of Congress in the enactment and of the commission in the administration of the law, if one of the results of the law's operation has been the subsidence of the initial distrust on the part of the states to which I have referred. That such has been the fact is the experience of the Southern Pacific Company, in witness whereof I cite the circumstances under which the unification by lease of the railroads of our system that lie east of El Paso was effected in 1926, six years after the enactment of the Transportation Act. This part of our system consists of a dozen or more railroad corporations, some creatures of Texas and some of Louisiana, with a combined mileage of over 5,000 miles located in the two states. They were already under common control through the ownership by the Southern Pacific Company of practically all the stock of each of the corporations. But under the laws of Texas and Louisiana it had been necessary for each corporation to operate its own railroad by its own officers. The object of the application of 1926 was to bring about a more complete unification by having one of the corporations lease the properties of the others and operate the whole under the lease. Such single operation would result in many economies, a large saving, for example, in accounting expense, and would generally work to the convenience and advantage of the carriers and of the public. This is so obvious as to suggest the inquiry why we waited for six years before applying for authority to make an intra-system unification so manifestly desirable. The answer is the initial distrust I have referred to and its gradual disappearance. If the application had followed close upon the passage of the Transportation Act it would have encountered opposition upon one or more of the following grounds: that local interests would suffer from unification under management centered at a distance; that the states' control over their own corporations would be weakened to a harmful extent; that the public interest would suffer from the suspension of the state anti-trust acts; that the operation of the railroads of one of the states by a railroad corporation of another state might result to the advantage of shipping inter-

ests of the state where the operating corporation was located. We might have succeeded before the commission, but the unfriendliness resulting from the contest would have gone far to offset the benefits resulting from the order of approval. It is a tribute to the law, and especially to the commission's administration thereof, that there was no serious opposition to the rendition by the commission in 1926 of an order whereby the operation of the railroads of the two states was turned over to a lessee, a corporation of one of the states.¹ We were fortunate to have available as the lessee company a corporation whose first name was Texas and whose last name was New Orleans.

The case I am now about to cite has been selected because it shows the good work of paragraphs 2 and 8 of Section 5 in removing otherwise insurmountable obstacles to a universally desired unification; because it reveals a state, probably the proudest and most touchy state in the Union, viewing with equanimity the setting aside of provisions of her own constitution; and because it affords a striking example of the accomplishment of one of the general purposes of the provisions of the Transportation Act under discussion, namely, the preservation of a potentially useful weak line by its union with a stronger line; for it resulted in the transformation of a broken-down railroad into an efficient and expanding transportation agency. I refer to our acquisition in 1925, by stock purchase and lease, of the San Antonio and Aransas Pass Railway Company, a Texas corporation then owning some 700 miles of railroad.

Some time before 1903 the Southern Pacific Company had acquired all the stock of the San Antonio and Aransas Pass, which I shall hereafter refer to by its nickname, the "S.A.P." On the faith of this stock ownership the Southern Pacific had guaranteed the principal and interest of seventeen and one-half millions of the S.A.P.'s bonds. There was some possibility of competition between the S.A.P. and the Southern Pacific's Texas lines. Any common control of parallel or competing lines was absolutely prohibited by the constitution of Texas. Hence, as in duty bound, the state authorities took such action as resulted in the enforced sale of the S.A.P.'s stock and a final injunction decree of a state court prohibiting the Southern

¹ 117 I. C. C. 504.

Pacific from ever exercising any control over that railroad. But the obligation from the guaranty of the bonds remained.

For the twenty-two years intervening between 1903 and 1925 the S.A.P.'s income was not sufficient to meet its fixed charges and the Southern Pacific had to make up the deficit, the deficiency during the period mentioned aggregating several million dollars. During all this period the S.A.P. was a weak line, affording unsatisfactory service, without funds or credit with which to make improvements or extensions necessary for its own development or to supply the growing needs of the country dependent upon it for transportation.

The Southern Pacific finally applied to the commission, under paragraph 2 of Section 5, for authority to reacquire the S.A.P.'s stock and to operate it as a part of its system, notwithstanding the court injunction and the prohibition of the state constitution. The shipping public of Texas, of course, favored the application. The attorney general of the state, as was his duty, appeared before the commission and, with a gesture towards the provisions of the state constitution, submitted that the application must be denied. When, however, the commission in the exercise of its powers, on finding the acquisition of control to be in the public interest, granted the order of authorization applied for,¹ there were no signs of falling tears or rising anger over the suspension of the state laws or the decree of the state court.

Since then the lines of the S.A.P. have been rehabilitated; over \$9,000,000 of capital expenditures have been made; and upwards of 150 miles of extensions have been constructed. The S.A.P. is now a well equipped, well maintained, first-class railroad. Moreover it has become an active and effective competitor of outside lines, thus creating more competition than was eliminated by its unification with the Southern Pacific system.

The fourth and last of the Southern Pacific's experiences which will be mentioned here, that is, the acquisition by the Southern Pacific Company of control of the El Paso and Southwestern Railway system, which took place in 1924, is probably the most important case of a unification under paragraph 2 of Section 5 of two large, prosperous, independent railway

¹ 594 I. C. C. 701.

systems. If space permitted, it would afford an opportunity to describe more in detail than I have yet done the factors which the commission has to consider in deciding whether the probable results of a proposed unification will be in the public interest. I shall have to content myself with saying that the relations of the two systems were those of competitors as to a comparatively small part of their traffic and of connections, each indispensable to the other, as to the vast preponderance of their traffic. With scarcely a discordant note, the people of the states in which the railroads concerned were located joined the two parent companies in asking for favorable action by the commission upon their joint application for authority to unify the two systems.¹ When the two systems were united they were found to fit into each other as smoothly as if originally designed to be amalgamated.

A very condensed abstract from the testimony in regard to the expected results of this unification (which have been in large measure realized) will bring before you in the shortest time a conception of the potential usefulness of the law. The anticipated results testified to were:

(1) Saving in administrative expenses by relief from the necessity which required each system, when independently managed, to employ a complete staff of executive, operating and legal officers.

(2) Avoidance of capital expenditure for enlargement of facilities which would have been necessary but for consolidation, and more complete utilization of shop facilities, yards, etc., of the two systems.

(3) Avoidance of construction of over 150 miles of main line double track due to the use of E. P. & S. W.'s road as a second line for through traffic.

(4) Improvement in train loading by diversion of through traffic to E. P. & S. W.'s underloaded trains.

(5) Correction of unbalanced traffic rendered possible by fact that S. P. had an excess of east-bound traffic while E. P. & S. W. had an excess of west-bound traffic.

(6) Creation of more effective and more beneficial competition than was eliminated by the unification.

¹ 90 I. C. C. 732.

(7) Many other operating economies which I have not time now to enumerate.

In regard to the experiences of the Southern Pacific Company that have been mentioned, it is a significant fact that all of the unifications had the enthusiastic support of the communities affected thereby and were found by the commission to be in the public interest, and yet that every one of them was within the condemnation of the constitution and statutes of the states in which the railroads concerned were located and in violation of pretty nearly every federal anti-trust act on the statute books. Is not this a demonstration of an imperative need for the provisions of the Transportation Act now under consideration?

In conclusion I am glad to have this opportunity to say that, considering the imperfect instrument placed in its hands by Congress and the novelty and difficulty of the questions with which it has had to deal, with scarcely any guiding precedents, the commission has, in my opinion, administered the unification provisions of the act, on the whole, with commendable wisdom and success. It deserves more praise than it has received for what it has done and less censure than it has received for what it has refrained from attempting to do under the law in its present form.

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THE EFFECT OF RAILROAD CONSOLIDATIONS ON RAILROAD SECURITIES

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RECENT financial history in the public utility, industrial and banking fields has been marked by numerous mergers and consolidations, which have usually been accompanied by substantial advances in the price of the securities of the companies or institutions involved. Railroad securities, in contrast, have been abnormally inactive. Only about two per cent of the trading on the New York Stock Exchange has been in railroad stocks, and their average prices are practically what they were two years ago. Had railroad consolidation been possible during this period, railroad securities would unquestionably have been much stronger and more active. As I understand the scope of this paper, however, we are not to discuss the transitory market effects of railroad consolidations, but rather to attempt to appraise their permanent effects.

As a starting point, it seems desirable to consider briefly the present status of railroad credit. That the carriers of this country are now being operated more efficiently than ever before, and are giving unequaled service, is widely recognized, but it is perhaps not so generally understood that railroad credit was never better, when measured by its own history.

In past years, railroads had the first call on the money market. They could raise more capital at cheaper rates than other private borrowers. Today, due to the deservedly increased popularity of public utility and industrial securities, they are confronted with keener competition. This indicates a rise in other types of credit, rather than a decline in railroad credit.

The ebb and flow of railroad credit is simple to trace. Using 1896 as a base, it shows a rapid and unbroken advance to 1907, thereafter, for fourteen years, a slow and an almost uninterrupted decline, reaching its nadir in 1921, and from that date to the present time a steady recovery.

The vital test of credit is ability to secure partnership capital. The cost of borrowing money varies with the interest rate, but a railroad's ability to sell stock varies with the investors' confidence in the industry. After 1907 fewer and fewer railroads could sell stock. The tide turned in 1922, and since then equity issues have grown in size and importance. Last year, for example, they amounted to \$192,000,000. In 1922 ninety-six cents of every dollar raised for the railroads was borrowed money, whereas in 1928 twenty-seven cents of each dollar was raised by sale of capital stock. You may say this still indicates too great dependence on borrowed money. On the other hand, had they so desired, many railroads which sold bonds last year might have issued stock. I have calculated that the railroad companies now in a position successfully to offer stock at par to their shareholders operate about 60% of the Class I mileage in the United States. In my opinion, this is a higher ratio than has existed previously in railroad history.

The latest official statistics are for 1927, in which year it appears that 70% of all railroad stocks received dividends. This is the highest percentage of stock in receipt of dividends since the Interstate Commerce Commission compilations began in 1888. Similarly, the average rate of dividends paid—approximately 6%—is the highest in the statistical records. In 1928, only one company reduced its dividend, while twelve placed their stocks on a dividend basis, or increased the rate previously paid. The position of the railroads last year was, therefore, more favorable than in 1927. Another evidence of the improvement in credit is the mileage operated by receivers, which is now smaller than at any time in the past eighteen years.

In presenting this optimistic picture of railroad credit I am not saying that, to assure the continuance of a steady flow of new capital into the business, it is even yet as good as it should be. Public utility stock issues alone last year exceeded by \$200,000,000 the entire capital raised by the railroads from bond and stock issues combined. The American Telephone and Telegraph Company stock, paying a 9% regular dividend, sells higher than most of the railroad stocks which are on a 10% basis. Not many months ago the telephone company sold with ease \$185,000,000 of new stock at par.

I do not think that there is in the United States today a railroad company which would venture to try to raise at one time so large a sum. Neither can one ignore certain disturbing tendencies in railroad affairs, such as the continuous decline since 1921 in the average rate per ton-mile, the tendency of wage advances to absorb a greater measure of the economies in operation, the losses in passenger business, the slower growth in freight tonnage, and the inability to earn a fair return on their investment. Nevertheless, I believe that at no time in their history have the railroads had better credit than they have today. If that is true, what, if anything, is there in consolidations which may affect their credit, favorably or adversely?

The Transportation Act stipulates that the Interstate Commerce Commission may at any time authorize one carrier to acquire another, either by lease or purchase of stock, *provided* that the consolidation of such carriers into a single system for ownership and operation is not involved, and that the public interest will be preserved. Under this paragraph of the law, during the past nine years, 254 applications for the acquisition by lease or purchase of stock have been approved by the commission. The most important during the past year was the approval of the application of the Chesapeake and Ohio to control the Pere Marquette, and that of the Atchison, Topeka and Santa Fe to acquire control of the Kansas City, Mexico and Orient. In the main, however, these authorizations have not fundamentally altered the preëxisting grouping of the carriers. They do not, therefore, afford much basis for the determination of the effect consolidations into single systems will produce upon railroad credit.

It is true that purchase of stock of one carrier by another, for the purpose of acquiring control, sometimes results in driving prices up to unwarranted levels, and thereby may make the cost of control a heavy burden upon the purchasing company. This consideration led Commissioner Eastman to write as follows, in his dissenting opinion on the "Control of the Erie and Pere Marquette by the Chesapeake and Ohio":

Nor is the method of bringing about railroad unifications by operations in a stock market fevered by such operations or prospect of them for the general good, however profitable it may be to individual oper-

ators. The result is to divert the credit of railroad companies, which ought to be conserved for transportation purposes, to the ends of speculation and private profit. The unifications which this method is likely to accomplish are those which offer the greatest opportunity for speculative profit, rather than those which offer the greatest opportunity for transportation advantage. The consolidations which the country needs are more apt to be those which offer so much prospect of mutual benefit that they can be agreed upon by direct negotiations of boards of railroad directors, and accomplished through exchange of shares without prior speculative operations.

The Transportation Act also directed the Interstate Commerce Commission to prepare and adopt a plan for the consolidation of the railroad properties of the country into a limited number of systems. Although the commission did publish a tentative plan on August 31, 1921, grouping the Class 1 carriers into nineteen systems, it did not allocate 39,000 miles of line, belonging to the Class 2 and Class 3 railroads. After numerous hearings, extending over two years, the commission announced that it was unable to agree on a final plan. As a practical matter it is doubtful that any individual or group of individuals has the vision and knowledge to prepare a plan acceptable to all parties. Since two or more carriers can consolidate their properties into one corporation for ownership, management and operation only when such consolidation is in harmony with the plan, no consolidations of this type have been effected. For the past four years the commission has asked Congress to amend the law by eliminating the requirement that it adopt and publish a final plan of consolidation.

The present law is also too rigid in that the bonds and stock at par of the consolidated corporation shall not exceed the value of the component properties, as determined by the Commerce Commission. The Parker-Fess Bill, now before Congress, substitutes the condition that there should be no capitalization of intangible values resulting from the proposed unification. The report accompanying the bill points out that there has been no overcapitalization since the commission received complete jurisdiction over the issuance of securities, and that it has been gradually "squeezing out the water" accumulated prior to that time. How much water remains to be "squeezed out", and will the process entail radical scaling

down of capital structures and consequent disturbance of railroad securities?

Consideration of the relationship between capitalization and valuation was given in the Nickel Plate Case, decided adversely by the Interstate Commerce Commission in 1926. Evidence was there introduced showing that the bonds and stock at par of the proposed company amounted to \$951,000,000. In the absence of completed valuations of the properties under Section 19a, a construction cost amounting to \$991,000,000, was found. This was based upon underlying engineering and land reports of the bureau of valuation, plus subsequent expenditures for additions and betterments, less depreciation of equipment at the rate of 4% per annum. Furthermore, this construction cost covered only physical railroad properties, and did not include allowances for materials and supplies, and other working capital, which the railway company estimated to be \$140,000,000. The commission stated, "If our final value should not fall substantially below these tentative estimates, the proposed capitalization is conservative." Unsoundness in capital structure was not the reason for the rejection of the Nickel Plate plan.

The commission's theories of valuation are challenged by the carriers, and the O'Fallon case, now before the United States Supreme Court, brings up some of those theories for judicial review. Still other theories will in time come before the Supreme Court. In the meantime, the so-called "O'Fallon Method" will afford minimum valuations to compare with capitalization figures. A complete comparison is impossible, since the valuation work is unfinished. However, significant figures are obtainable. I have selected seventy-six important carriers, operating 210,000 miles of road, or 88% of the Class 1 mileage. To their tentative or final valuations I have added the net additions and betterments from the inventory dates, together with the value of non-carrier property and security investments at their book values. The sum of these figures gives a total value, as of December 31, 1927, of substantially \$22,100,000,000, and the par value of the outstanding capitalizations in the hands of the public on the same date was \$18,200,000,000. The excess of value over the par value of securities, is, therefore, \$3,900,000,000.

Of these seventy-six railroad companies, however, forty-seven are undercapitalized on the basis I have used, while twenty-nine are overcapitalized. The exact figures are—

	<i>Valuations brought down to date</i>	<i>Par value of capitalization</i>	<i>Mileage</i>
47 companies	\$18,100,000,000	\$13,400,000,000	151,000
29 companies	4,000,000,000	4,800,000,000	59,000

Thus the first group of roads has a valuation in excess of capital of \$4,700,000,000, or 26%, while the second group has capital in excess of valuation of \$800,000,000, or 21%. It is, therefore, evident that the companies controlling 72% of the mileage embraced in this comparison have no "water to be squeezed out". Of the remaining 28%, in a considerable number of cases, the prices of the securities in the market are substantially below par, and so might not require scaling down in a consolidation.

Manifestly, undercapitalized companies, such as the Pennsylvania, the Burlington and the Santa Fe (to mention only a few), will not surrender in consolidation equities which have been built up during years of conservative finance, and which belong to their stockholders, for the benefit of the stockholders of less conservatively financed companies. But the holder of the stock of a railroad company which has never paid a dividend and which is selling for \$25 a share would not be reluctant to exchange, say, four shares of his stock for one share of the stock of a strong dividend-paying company, selling at \$100 a share. In this way the scaling of the par value of an overcapitalized road could be accomplished without market disturbance. Objection might come from the stockholder of the strong road, if he feared that the safety of his dividend, or the chance of its being increased, might be impaired by the dilution of this stock through consolidation with the weaker company. Such objection, however, can be overcome if the consolidation should result in the more effective and profitable use of the weaker carrier.

Inasmuch as railroad capitalization is, on the whole, so amply supported by sound values, we may eliminate the fear that watered stock may unfavorably affect credit when consolidations are taking place. There are other factors, however,

to be considered. Some will be advantageous—others not. For example, certain of the smaller railroad properties possess today unusually high credit, such as the Morris and Essex, the Central Railroad of New Jersey, and the Nashville, Chattanooga and St. Louis. Each of these companies, over a year ago, sold blocks of bonds on not far from a 4½ basis. Consolidation will mean the disappearance of these individual credits, and it is probably true that a succeeding consolidated company will not enjoy such high credit. The roads mentioned are in the rare position of having open first mortgages. The consolidated corporations which take over these roads will doubtless do their financing through junior mortgages, and will have to accept lower prices for their securities. On the other hand, there are a larger number of small roads which have inferior credit, so that the succeeding consolidated company should be able to command capital more cheaply and easily. Again, a consolidation may produce a simplified capital structure, which is of considerable advantage.

In a normal bond market bankers prefer to offer several different issues of moderate size rather than one very large issue, since the demand of the investor for diversification makes the sale of the larger issue much more difficult. The offering, for example, at various times, of \$25,000,000 Great Northern, \$25,000,000 Northern Pacific, and \$25,000,000 Burlington bonds would be more certain of prompt and satisfactory distribution than the sale at one time of \$75,000,000 of bonds of a company representing the consolidation of these three lines. Many investors, both private and institutional, will take only a certain amount of bonds, be the issue \$10,000,000 or \$100,000,000, unless encouraged by an exceptionally attractive price. A great system will require a larger amount of money in a single sale of securities than our existing systems do. The cost of that money may easily be somewhat greater than it would have been to the several predecessor companies which compose the consolidation. In a poor bond market, such as we are now experiencing, the situation may become serious. Due, as I believe, to the mistaken policy of the Interstate Commerce Commission in compelling competitive bidding for equipment trust issues, the market for that class of securities has become very narrow. Small issues of from \$2,000,000

to \$10,000,000 can be distributed slowly, but if a great consolidated system were now to offer \$50,000,000 equipment certificates I question whether the issue could be sold at all, except upon relatively exorbitant terms. Maintenance of a high standard of credit thus becomes more essential as the size of the corporation increases.

Senator Cummings said, "The object of consolidation is to keep the weak roads running", and Commissioner Meyer wrote, "The unification of the weak with the strong lines is one of the needs which Congress apparently had most definitely in mind." There is unquestionably considerable anxiety that, while the taking over of weak lines may serve the transportation requirements in certain sections of the country, it may place an unjustifiable burden upon the strong lines, and that instead of lifting the general average of service it may depress it. While it is true that some of the so-called "weak lines" are so because of burdensome debt or inefficient management, it is also true that there are not a few lines the ownership of which seems likely to be a liability to any strong system that acquires them. The attitude of the Interstate Commerce Commission toward this problem is not fully revealed in any of its decisions up to the present time. In the Nickel Plate case, in 1926, it stated: "When these unifications are being considered, the problem of the short lines whose property, in the public interest, should be included in the systems proposed, cannot be overlooked, *if it is possible to include them upon reasonable terms.*"

In the New York Central lease case, decided last month, the commission went one step further and indicated what it regarded as "reasonable terms". Its consent rests on the express condition that the New York Central shall offer to acquire certain connecting lines for "considerations equal to the commercial value of the respective properties, as determined by agreement between the parties, or by arbitration." Further, the New York Central is admonished to approach the consideration of the inclusion of additional short line railroads, if and when proposed, "in a spirit of coöperation."

What is the "commercial value" of a weak road? If it has a physical valuation of a million dollars, and net earnings of only \$5,000 a year, surely the "commercial value" does not

approximate the physical value. Profitable short lines are usually not for sale. It is generally only the distressed short line that seeks to unload upon the strong connecting carrier. Despite this fact, I am of the opinion that it will be possible to take care of the weak lines on terms that will not injure the strong roads.

My survey of the situation leads me to the conclusion that the permanent effects of railroad consolidation on railroad securities are likely to be of minor, not major, importance. Rates, taxes, wages, traffic trends, are the vital factors. If these are favorable, railroad credit will continue to rise. If not, railroad credit will decline, whether we have nineteen consolidated systems, or the present 2,203 separate companies.

OBSTACLES TO RAILROAD CONSOLIDATION IN EASTERN TERRITORY

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CONSOLIDATION is the tendency of the times in most lines of business. During recent years public sentiment has changed from opposition to approval of large organizations, it having been demonstrated that such organizations are in most instances more economical and effective. Change of public sentiment toward railroad consolidation came earlier than the approval of consolidation in finance and production. As far as public opinion is concerned there is no longer any general or theoretical opposition to reducing the number of railroad systems.

The men who own and manage railroads have for the most part always been in favor of consolidation, and in spite of legal restraint and adverse public sentiment there has been a continuous evolution of railroad integration. Indeed, while there are at present about 180 large railroad companies (Class 1 railroads having earnings of \$1,000,000 or more per annum) they are so related to each other that twenty-two systems, using that term in a loose way as expressive of financial control, now include 79% of the railway mileage of the country and 82% of the property investment, and secure 84½% of the gross earnings. This evolution is now going on in spite of the obstacles imposed by the Transportation Act of 1920. An analysis of some of the obstacles that have limited consolidation in eastern territory will indicate the situation that prevails generally throughout the country.

Legal Obstacles: Defects of the Act of 1920

The Transportation Act of 1920, which was adopted by Congress upon the return of the railroads to their owners at the close of the period of government operation, was intended among other things actively to promote the grouping of rail-

roads into a limited number of systems of relatively equal strength. The results of the act as regards railroad consolidation have not been successful. This has been due both to positive and to negative defects in the law.

The consolidation and merger provisions of the act of 1920 are contained in Section 5, paragraphs 2 to 6 inclusive. Paragraphs 2 and 3 authorize incomplete consolidations and permit a railroad, with the approval of the Interstate Commerce Commission, to acquire control of another railroad by lease or stock purchase "or in any other manner not involving the consolidation of such carriers into a single system for ownership or operation". This provision of the law authorizes incomplete consolidation. The railroads brought together are to maintain their corporate and operating identity, they are not to be merged into a single system. It is not possible for one railroad company under these paragraphs of the act to buy out another company and take its place.

The complete merger of railroads as contemplated by Congress in adopting the provisions of paragraphs 4 to 6 inclusive of Section 5 of the Interstate Commerce Act as amended must conform to a prearranged general plan of grouping of all railroads in the United States. The Interstate Commerce Commission is directed to decide upon and promulgate a plan for the grouping of all the railroads, and individual mergers can be authorized only after such plan has been adopted and only when the individual mergers are in harmony with the general plan. This provision of the law has prevented any complete mergers from taking place since 1920. The commission has not promulgated a general plan of railroad grouping. Indeed, it has several times requested Congress to be relieved of that duty.

The commission realizes that it requires a greater measure of prescience than it possesses to forecast the logical grouping of railroads, and that, however wisely the commission might act today in the adoption of the general plan, it would be obliged in passing upon future applications for individual mergers to deviate from the plan adopted in advance. It is also quite certain that the definite allocation of railroad systems to designated consolidations in advance of their being brought together would increase the price demanded by individual

railroad companies for their property when they entered a consolidation. It is generally recognized both in and out of Congress that it is necessary to substitute for the merger sections of the act of 1920 a new plan for the government regulation and guidance of railroad consolidation.

In addition to the two positive defects in the act of 1920 that have been named there are two negative ones that call for consideration. The Transportation Act makes no provision for the acquisition by a consolidating company of the stocks of dissenting minority stockholders. A railroad company may buy the majority of the stock of another railroad company and the holders of the majority of the voting stock of any railroad company may authorize the lease of their road to another company, provided the Interstate Commerce Commission approves of the stock purchase or the lease. When the petition comes before the commission dissenting stockholders may object, and have very effectively objected, to proposed consolidations. No provision is contained in the law whereby the stocks owned by dissenting stockholders may be acquired without their consent. The bill that was proposed in the Senate near the close of the last session by the Committee on Interstate Commerce, of which the Honorable Simeon D. Fess is chairman, provided for the acquisition of the stocks of minority stockholders by condemnation and purchase at a fair price.

The act of 1920, furthermore, made no special provision for the inclusion of short line railroads that might be omitted from proposed consolidations and that might desire to be included. The Interstate Commerce Commission, however, has met this situation adequately by the practice it now follows of requiring those who petition for the approval of a consolidation to include among the roads to be acquired such short lines as may desire to be included and as ought, in the judgment of the Interstate Commerce Commission, to be made a part of the proposed group. The Fess Bill, if adopted, will enact into law the present practice of the Interstate Commerce Commission as regards the inclusion of short line railroads in the enlarged systems of the future.

Opposition of Local Business Interests

One of the obstacles that may prove to be difficult to overcome in bringing about the consolidation of railroads is that created by opposition of the local business interests which for various reasons may desire the continuance of the separate existence and activity of such railroads as may be considered to be of special local importance. This opposition may be illustrated by reference to the situation in Philadelphia and in Baltimore.

The business organizations in Philadelphia are opposed to the Reading Railway's becoming a part of another system not primarily interested, as is the Reading, in the development of the traffic and trade of Philadelphia. These business organizations have formed a joint committee to appear before the Interstate Commerce Commission when the commission has hearings upon the petition of the Baltimore and Ohio Railroad to acquire the Reading Railway and its controlled line, the Central Railroad of New Jersey. This opposition of the business interests of Philadelphia is one that they might be expected to have, because the Reading Railway has always been especially concerned with increasing its traffic through the port of Philadelphia. It has made liberal investments in terminal facilities. It is regarded by Philadelphia as its particular champion, whereas the Baltimore and Ohio has always been especially interested in the development of traffic through the Baltimore gateway. It does not follow that the acquisition of the Reading by the Baltimore and Ohio would cause the Baltimore and Ohio to interfere with the continued activity of the Reading in the development of the traffic at Philadelphia, but in the minds of the business men of Philadelphia there is the apprehension that the Baltimore and Ohio will give first consideration to Baltimore and will also compete with especial zeal at New York for the commerce to and from that great traffic center.

If the railroads in the eastern territory are eventually consolidated into four large systems it is quite certain that one of the four will be the Baltimore and Ohio system and that this strong system will include the Western Maryland, a road that is relatively small and financially weak. However, certain busi-

ness interests in Baltimore desire that the Western Maryland shall remain independent of the Baltimore and Ohio Railroad, the hope being that Baltimore may thereby ultimately have a strong third trunk-line system. This could come about only by the Western Maryland's being made a part of a through rail route from Chicago and the Great Lakes to Baltimore, in accordance with a plan of grouping that would be opposed by the majority of the eastern trunk-line systems. It is natural that the business men of Baltimore should prefer to have three trunk lines in the future, instead of two, provided it is possible to bring about such a grouping of the railroads in the eastern territory as will make that possible.

Conflicting Interests and Aims of the Eastern Trunk Lines

The most serious obstacles to be overcome in bringing about the consolidation of railroads in the eastern territory are neither those due to the provisions of the act of 1920 nor those created by the opposition of local business interests, but those that result from the historic rivalries of the trunk lines themselves. The history of railroad competition in the territory between New York, Chicago and St. Louis, of the rate wars of the 1870's and 1880's, and of the powerful though regulated rivalries that have continued to the very present need not be recited here. It is a matter of common knowledge that every phase of railroad competition has been illustrated during the past fifty years by the relations of the eastern trunk lines to each other. The trunk lines are rivals today as they have been in the past and there will be active competition in the future among the four systems, should the contemplated consolidations take place.

Reference to a few of the conflicting interests and aims of the eastern trunk lines will indicate the nature of the obstacles to consolidation. The New York Central for seventy-five years has held, and now maintains, a dominant position as the carrier of the traffic through the Buffalo gateway. It has the advantage over the other large trunk lines for handling the traffic between the Great Lakes and New York City. Naturally the New York Central has no desire to see its superiority in the Great Lakes - New York traffic lessened by the process of consolidating the eastern trunk-line railroads.

The Pennsylvania Railroad was built to connect Philadelphia with the Ohio River and the Ohio Valley. The Pittsburgh district holds first place in the United States in the tonnage of heavy traffic. There are also large traffic currents flowing through the Pittsburgh portal between the West and the East. The New York Central and other railroads share with the Pennsylvania Railroad in the traffic of and through Pittsburgh, but the Pennsylvania outranks all other carriers in this section.

The Baltimore and Ohio holds first place at Baltimore. Its long and only partially successful struggle to reach Philadelphia and New York on an equal footing with other railroads is well known. The Baltimore and Ohio is particularly desirous of strengthening its position at New York as a result of the contemplated grouping of eastern carriers.

Five years ago a new eastern trunk line of major importance suddenly came into existence. The two financial geniuses who gave renewed life to the Nickel Plate have built around it a grouping of railroads having a common financial control, the group including the Chesapeake and Ohio, the Hocking Valley, the Pere Marquette and the Erie. This new railroad interest comes into competitive rivalry with all of the other trunk lines, particularly with the Pennsylvania and the Baltimore and Ohio system.

The Pennsylvania Railroad's relation to the New York Central presents special difficulties to be overcome in grouping the eastern carriers. The Pennsylvania has three urgent needs the satisfaction of which runs counter to the interests of the New York Central. In general, the Pennsylvania wishes to participate under more favorable conditions in the traffic to and from the Great Lakes and in the shipments to and from the large and growing cities on Lake Erie from Buffalo to Toledo inclusive. The Pennsylvania has a roundabout line from Buffalo to New York by way of Harrisburg and Trenton. It desires a direct line such as it would have if it acquired the Lehigh Valley. Moreover, the Pennsylvania reaches Toledo, Cleveland, and other cities on the south shore of Lake Erie by branches from its main line between Pittsburgh and Chicago. In order to participate in the traffic of the Great Lakes and the cities on Lake Erie under advantageous condi-

tions it needs a line along the south shore of Lake Erie—either a line of its own or, in lieu thereof, trackage rights on one of the existing roads paralleling Lake Erie. The third need of the Pennsylvania in connection with its traffic into the New York district is for additional tracks for a distance of about thirty miles. It would be difficult and extremely expensive to increase the tracks of its present line for thirty miles out of New York, and if the Pennsylvania can secure such a road as the Lehigh Valley the need for additional trackage into New York will be adequately met. These thirty miles impose the most definite limit upon the tonnage that may be handled by the Pennsylvania Railroad and upon the future development of its traffic, particularly that between the southeastern part of the United States and New York and New England.

It is easy to see why the Pennsylvania is desirous of acquiring the Lehigh Valley and also of entering into the trade via the Great Lakes and lake ports under more favorable conditions. The New York Central will naturally endeavor to maintain its *status quo*. It will probably desire to share more largely than it now does in the traffic of the coal and iron industries centering about Pittsburgh, traffic that is most advantageously carried by the Pennsylvania system. On the whole, however, the Pennsylvania Railroad has more prospect of improving its status in working out a grouping of the eastern railroads than has the New York Central system.

The Baltimore and Ohio and the Pennsylvania railroads have always been active competitors, but in order to be in a position to compete effectively with the Pennsylvania Railroad between Chicago and New York the Baltimore and Ohio needs a direct route from Pittsburgh to New York and needs to acquire the Reading Railway and the Central Railroad of New Jersey in order to reach the New York terminal district over its own tracks and to have necessary terminals in the New York area. It will run counter to the interest of the Pennsylvania Railroad to have the Baltimore and Ohio acquire the Reading and Jersey Central. Furthermore, the Baltimore and Ohio has included in its petition recently filed with the Interstate Commerce Commission the request for trackage rights for eighty-one miles in central Pennsylvania over the Pennsylvania road or alternatively over the Pennsylvania and New York

Central lines. This request is made in order to enable the Baltimore and Ohio, by means of the additional roads it hopes to acquire in the process of consolidation, to establish a direct line between Pittsburgh and New York City.

Plans for the consolidation of the eastern trunk lines had to be revised a few years ago when the Van Sweringen brothers of Cleveland brought about the Nickel Plate consolidation and acquired a controlling interest in the Chesapeake and Ohio, the Pere Marquette and the Erie. It is admitted by everybody that one of the permanent future systems in the eastern trunk-line territory will be what was formerly called the Nickel Plate system, but which has now become the Chesapeake and Ohio system due to the fact that the Chesapeake and Ohio in February of this year filed a petition with the Interstate Commerce Commission seeking its approval of the grouping of the roads controlled by the Van Sweringen brothers and the Nickel Plate interests.

The New York Central is presumably not opposed to the Chesapeake and Ohio grouping and for the most part the Baltimore and Ohio's interests have been harmonized with those of the Chesapeake and Ohio. There are, however, two railroads occupying a strategic position with reference to the eastern trunk lines, and it will probably be necessary for the commission to decide what disposition shall be made of these roads. The Wheeling and Lake Erie connects the Pittsburgh district with the Lake Erie ports. The Van Sweringen brothers have requested approval of their purchase of the control of the Wheeling and Lake Erie, and the Baltimore and Ohio in its petition recently filed requests certain trackage rights over the Wheeling and Lake Erie. What the attitude of the Pennsylvania Railroad may be towards the acquisition of the Wheeling and Lake Erie by one of the trunk lines remains to be seen.

The Baltimore and Ohio Railroad desires to acquire the Wabash system. The Pennsylvania Railroad would evidently prefer that this should not happen, as evidenced by the fact that the Pennsylvania has purchased a large minority of the stock of the Wabash.

One ambitious railroad interest of minor importance is that of the Pittsburgh and West Virginia, controlled by Mr. F. E. Taplin and his brother, who are building a twenty-eight-mile

branch connecting their road with the Western Maryland at Connellsville, Pa. The Pittsburgh and West Virginia connects with the Wheeling and Lake Erie. Should the Pittsburgh and West Virginia interests, under the leadership of the Taplins, acquire control of the Western Maryland and the Wheeling and Lake Erie, there will be a new system to recognize connecting Lake Erie ports and the Pittsburgh district with Baltimore.

The foregoing is a statement of only a portion of the conflicting interests which the trunk lines will have to adjust in order to bring about the consolidation of the railroads in the eastern territory. These conflicting interests can hardly be reconciled by negotiations of the trunk lines with each other. Such negotiations have been in progress for five years and thus far without success. It will apparently be necessary for each of the four proposed systems to file petitions with the Interstate Commerce Commission setting forth such distribution of the individual railroads as the several petitioners desire. There will be conflicting claims which the Interstate Commerce Commission will have to adjust, and it will be necessary for the commission to decide as to the allocation of a number of the lines.

The Baltimore and Ohio and the Chesapeake and Ohio railroads have taken the lead in bringing definitely before the Interstate Commerce Commission the task of deciding upon the consolidation of the railroads in the eastern territory. Each petitioner has enumerated the roads which it wishes to include within its system and has asked the commission whether it approves of the proposed grouping. It requests the commission to designate what changes, if any, are deemed necessary in the proposed allocation of the several lines. The petitioners also offer to endeavor to acquire such connecting short lines as in the judgment of the commission should be included in the proposed consolidations.

The probable result of the action taken by the Baltimore and Ohio and the Chesapeake and Ohio petitioners will be that the New York Central will file with the commission a petition setting forth the roads it desires to include in its future system. Ultimately the Pennsylvania Railroad will doubtless petition the commission for approval of such grouping as it desires. It

is probably a safe guess that the Pennsylvania's petition will be the last one filed, but ultimately it will unquestionably be obliged to bring its wishes to the bar of the commission. It is not to be expected that the commission will act upon its own motion to force the eastern lines to consolidate into four groups or any other number of systems. The commission will quite certainly limit its actions to propositions put before it by the interested trunk lines.

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THE PROGRESS OF UNIFICATION

RICHARD WATERMAN

Chamber of Commerce of the United States

THE accompanying chart has been prepared for the purpose of showing that during the first hundred years of railroad development in the United States there has been substantial progress toward railroad consolidation as defined in the Transportation Act, 1920—that is, toward the creation of a limited number of strong competing systems that shall be, so far as practicable, equal in strength and in earning power.

The chart is based on a statement made by President Rea of the Pennsylvania Railroad in 1923, when he appeared at the hearings on railroad consolidation before the Interstate Commerce Commission and said: "About 22 recognized railroad systems now earn nearly 85 per cent of the transportation revenues of the country. . . . In 1922, 84.7 per cent of the total operating revenue of Class I railways was earned on the Class I roads embraced in the following systems. . . ." He then put into the record the list of systems that is used as a basis for his chart.

Each of these twenty-two systems is composed of a number of Class I railroads that were formerly independent, but have now been brought under a unified policy of management through acquisition of financial control. A Class I road is one that earns more than \$1,000,000 a year. There are in the United States 172 Class I roads. They earn 96 per cent of the gross revenues of all railroads. The twenty-two systems shown include eighty-one of these Class I roads.

The tabular statements accompanying the chart present a comparison of miles of line, miles of track, property investment and gross earnings of each of these twenty-two systems, with the corresponding items for all Class I railroads.

They show, for example, that the New York Central system, which includes six Class I railroads, has 11,784 miles of line, or 4.9 per cent of the total miles of line for all Class I railroads; 27,796 miles of track, or 6.9 per cent of the total; a property investment of \$2,148,000,000, or 8.5 per cent of the total; and

that in 1928 this system earned \$601,000,000, or 9.8 per cent of the gross revenues of all Class I railroads.

The table entitled "Systems and Class I Roads" gives the name and mileage of each Class I road that is included in one of the twenty-two systems. In order to compare the totals for the nine systems that operate in Eastern territory with the totals for all Class I roads in the United States, it is necessary to subtract the item for "other roads of Eastern District" from the "total for Eastern District" in each column. Using this method we find that the nine systems in Eastern territory have 19.8 per cent of the total miles of line; 27.2 per cent of the total miles of track; 37.1 per cent of the total property investment; and that in 1928 they earned 41.2 per cent of the gross revenues of all Class I roads.

The three systems in Southern territory have 13.2 per cent of the total miles of line; 12.6 per cent of the total miles of track; 10.6 per cent of the total property investment; and in 1928 they earned 10.9 per cent of the gross earnings of all Class I roads.

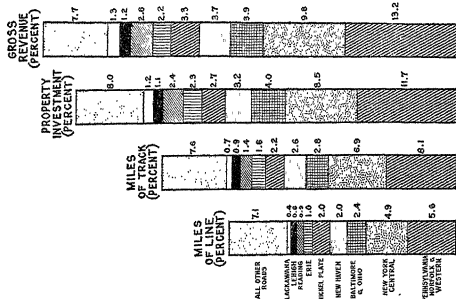
The ten systems in Western territory have 46.3 per cent of the total miles of line; 39.9 per cent of the total miles of track; 34.2 per cent of the total property investment; and in 1928 they earned 32.4 per cent of the gross revenues of all Class I roads.

The figures given in this table and chart afford an opportunity to show how different conditions in different parts of the country affect the growth and the unification of railroads. For example, three systems—the Pennsylvania-Norfolk and Western in the East, the Atlantic Coast Line-Louisville and Nashville in the South, and the Southern Pacific in the West—have about 13,500 miles of line apiece, but they differ greatly in miles of track, property investment and gross earnings per mile.

The Pennsylvania-Norfolk and Western system serves a territory that has great density of population and a corresponding density of traffic. Therefore it requires a relatively large mileage of additional track, and expensive terminals in the large industrial centers through which it passes. The result is that on this system the number of miles of track is 139 per cent greater than miles of line, property investment is \$219,799 per mile, and gross earnings are \$59,873 per mile of line operated.

UNIFICATION OF RAILROADS.

EASTERN TERRITORY COMPARISON WITH ALL CLASS 1 ROADS



Explanation of Chart

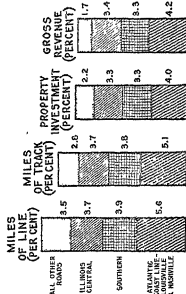
22 Railroad systems now control 79.3 percent of the total miles of line and earn 84.5 percent of the gross revenues of all Class 1 railroads xxx

There are 172 Class 1 railroads in the United States xxx They earn 96 percent of the gross revenues of all railroads xxx The 22 systems shown on this chart include 81 of these Class 1 roads xxx

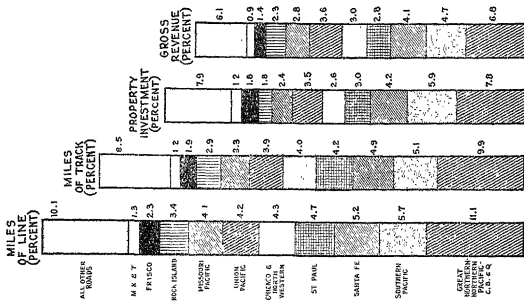
Each of the 22 systems shown is composed of a number of railroads - formerly independent - that have now been brought under a unified policy of management through acquisition of financial control xxx

Complete unification of any one of these systems can be accomplished only by merger or by consolidation into a single corporation.

SOUTHERN TERRITORY COMPARISON WITH ALL CLASS 1 ROADS



WESTERN TERRITORY COMPARISON WITH ALL CLASS 1 ROADS



UNIFICATION AND COMPARISON OF RAILROADS
CHARTER OF CONGRESS OF THE UNITED STATES

UNIFICATION OF RAILROADS

A COMPARISON OF 22 SYSTEMS WITH ALL CLASS I RAILROADS—1928

Name of System	Miles of Track	Property Investment	Gross Revenue
EASTERN DISTRICT			
1. Delaware, Lackawanna & Western	2,729	\$313,870,379	\$81,138,442
2. Lehigh Valley	3,583	272,937,948	71,935,071
3. Reading-Central of New Jersey	5,542	619,452,526	155,340,581
4. Erie	6,342	583,191,240	131,516,947
5. Chesapeake & Ohio-Nickel Plate, etc. .	8,678	688,633,943	198,502,924
6. New Haven-Boston & Maine	10,528	798,377,296	226,908,008
7. Baltimore & Ohio	11,149	1,006,842,606	239,946,342
8. New York Central	27,796	2,148,243,117	601,014,186
9. Pennsylvania-Norfolk & Western	32,234	2,968,166,020	808,531,097
Other roads of Eastern District	30,462	2,017,010,289	470,749,900
Total—Eastern District	139,043	\$11,416,725,364	\$2,985,583,498
SOUTHERN DISTRICT			
10. Illinois Central	14,612	825,101,453	207,805,455
11. Southern	15,120	834,153,317	204,425,315
12. Atlantic Coast Line-Louisville & Nash- ville	20,437	1,001,877,984	256,910,682
Other roads in Southern District ..	11,362	570,752,618	102,641,991
Total—Southern District	61,531	\$3,231,885,372	\$771,783,443
WESTERN DISTRICT			
13. Missouri, Kansas & Texas	4,778	296,004,604	56,549,119
14. St. Louis-San Francisco	7,459	455,189,121	85,380,851
15. Chicago, Rock Island & Pacific	11,504	463,411,501	141,232,604
16. Missouri Pacific	13,404	616,917,885	166,977,464
17. Union Pacific	15,547	890,129,263	219,243,108
18. Chicago & Northwestern	16,061	647,641,364	179,152,807
19. Chicago, Milwaukee, St. Paul & Pacific ..	16,839	758,961,014	170,554,899
20. Atchison, Topeka & Santa Fe	19,615	1,078,110,087	247,632,837
21. Southern Pacific	20,253	1,496,277,775	289,100,668
22. Great Northern-Northern Pacific- C. B. & Q.	39,436	1,969,900,734	417,293,081
Other roads in Western District ..	33,744	1,992,483,184	373,837,953
Total—Western District	198,640	\$10,665,026,532	\$2,346,955,391
Grand Total—United States	399,214	\$25,313,637,268	\$6,104,322,332

Source: Reports of Bureau of Railway Economics.

Prepared by the Transportation and Communication Department of the Chamber of Commerce of the United States to accompany chart showing Unification of Railroads, April, 1929.

The Atlantic Coast Line-Louisville and Nashville, with about the same mileage as the Pennsylvania, serves a territory that has less density of population and less density of traffic, and does not require so much additional track or as large and expensive terminals. On this system the number of miles of track is only 53 per cent greater than miles of line, the property investment is \$74,957 per mile, and gross earnings are \$19,221 per mile of line operated.

The Southern Pacific system serves a territory that is in many places very sparsely inhabited, and the character of its traffic is different from that of either of the other roads. On this system the number of miles of track is 49 per cent greater than miles of line; property investment is \$109,746 per mile, and gross earnings are \$21,204 per mile of line operated.

The Great Northern-Northern Pacific-Burlington system, with a mileage nearly twice as great as that of the Pennsylvania, is obliged to meet traffic and operating conditions that differ in many respects from those which obtain on the other three systems used in this comparison. On this system the number of miles of track is 48 per cent greater than miles of line, property investment is \$74,179 per mile, and gross earnings are \$15,714 per mile of line operated.

Nevertheless, in spite of widely different conditions each of these four systems has achieved the position of a strong road—that is, each has a sound financial structure, and obtains annual net earnings that enable it to pay regular and satisfactory dividends.

The chart shows that the Pennsylvania - Norfolk & Western System includes four Class 1 railroads; the Atlantic Coast Line-Louisville & Nashville, nine Class 1 roads; the Southern Pacific, two Class 1 roads; the Great Northern - Northern Pacific - Burlington, seven Class 1 roads; and so on for the other systems. In each instance these Class 1 roads have been brought under a unified policy of management through acquisition of financial control. Complete unification of any one of these twenty-two systems can be accomplished only by merger or by consolidation of all of the roads within the system into a single corporation.

SYSTEMS AND CLASS I ROADS

<i>Eastern District</i>	<i>Miles of Line</i>
1. Delaware, Lackawanna & Western	998
2. Lehigh Valley	1,364
3. Reading—Central of New Jersey	
Reading Co.	1,141
Atlantic City	163
Central of New Jersey	691
Perkiomen	42
Port Reading	20
Total	2,056
4. Erie	
Erie Railroad	2,047
Chicago & Erie	270
New Jersey & New York	46
New York, Susquehanna & Western	133
Total	2,495
5. Chesapeake & Ohio—Nickel Plate	
New York, Chicago & St. Louis	1,691
Chesapeake & Ohio	2,724
Hocking Valley	349
Total	4,763
6. New Haven—Boston & Maine	
New York, New Haven & Hartford	2,149
New York, Ontario & Western	569
Boston & Maine	2,111
Total	4,830
7. Baltimore & Ohio	
Baltimore & Ohio	5,638
Staten Island Rapid Transit	23
Total	5,661
8. New York Central	
New York Central R. R.	6,906
Cleveland, Cincinnati, Chicago & St. Louis	2,397
Cincinnati Northern	244
Evansville, Indianapolis & Terre Haute	146
Michigan Central	1,859
Pittsburgh & Lake Erie	231
Total	11,783

9. Pennsylvania—Norfolk & Western

Pennsylvania R. R.	10,488
Long Island	404
West Jersey & Seashore	370
Norfolk & Western	2,241

Total 13,503

All other roads in Eastern District 16,989

Total, Eastern District 64,443

Southern District

10. Illinois Central

Illinois Central	6,710
Central of Georgia	1,917
Gulf & Ship Island	308
Yazoo & Mississippi Valley (included in Ill. Central)	—

Total 8,935

11. Southern

Southern	6,761
Alabama Great Southern	315
Georgia Southern & Florida	399
Mobile & Ohio	1,160
New Orleans & Northeastern	204
Northern Alabama	110
Cincinnati, New Orleans & Texas Pacific	338

Total 9,287

12. Atlantic Coast Line—Louisville & Nashville

Atlantic Coast Line	5,118
Atlantic & West Point	93
Atlanta, Birmingham & Atlantic	640
Charleston & Western Carolina	342
Clinchfield	309
Georgia	329
Louisville & Nashville	5,076
Louisville, Henderson & St. Louis	199
Nashville, Chattanooga & St. Louis	1,260

Total 13,366

All other roads in Southern District 8,501

Total, Southern District 40,090

Western District

13. Missouri, Kansas & Texas	
M. K. & T. of Texas	3,189
Total	3,189
14. St. Louis—San Francisco	
St. Louis & San Francisco	5,263
Fort Worth & Rio Grande	234
St. Louis—San Francisco of Texas	148
Total	5,645
15. Chicago, Rock Island & Pacific	
Chicago, Rock Island & Pacific	7,566
Chicago, Rock Island & Gulf	516
Total	8,082
16. Missouri Pacific	
Missouri Pacific	7,445
New Orleans, Texas & Mexico	191
Beaumont, Sour Lake & Western	153
International Great Northern	1,160
St. Louis, Brownsville & Mexico	617
San Antonio, Uvalde & Gulf	318
Total	9,884
17. Union Pacific	
Union Pacific	3,732
Los Angeles & Salt Lake	1,209
Oregon Short Line	2,539
Oregon—Washington R. R. & Navigation	2,354
St. Joseph & Grand Island	258
Total	10,092
18. Chicago & North Western	
Chicago & North Western	8,463
Chicago, St. Paul, Minneapolis & Omaha	1,746
Total	10,209
19. Chicago, Milwaukee, St. Paul & Pacific	
	11,251
20. Atchison, Topeka & Santa Fe	
Atchison, Topeka & Santa Fe	—
Gulf, Colorado & Santa Fe	—
Pan Handle & Santa Fe	—
Total	12,388

21. Southern Pacific	
Southern Pacific	8,906
Texas & New Orleans	4,728
	<hr/>
Total	13,634
22. Great Northern—Northern Pacific—C. B. & Q.	
Great Northern	8,267
Northern Pacific	6,730
Chicago, Burlington & Quincy	9,375
Colorado & Southern	1,041
Fort Worth & Denver City	621
Wichita Valley	272
Quincy, Omaha & Kansas City	250
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Total	26,556
All other roads in Western District	24,241
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Total, Western District	135,173
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Grand total for the United States	239,706

DISCUSSION¹

CHAIRMAN HINES: I should like to close the session with two or three comments which have been suggested to me by the discussion which has taken place. I want to reiterate the importance of bearing in mind the distinction between the two sorts of rail combinations which are contemplated by the act. While we must all admit that no progress has been made in actual consolidation under the consolidation branch of the act, whereby railroads not now in the same system would be vested in a single corporation for legal ownership and operation, nevertheless, the other branch of the act is very important and is, after all, susceptible of independent application, and these unifications through control or lease have moved forward. Perhaps the very fact that consolidation has been delayed by the complexities of the problem may be regarded as a clear justification of the action of Congress in providing for this other means of railroad combination which has been going forward, and, I believe, in a constructive manner.

When Professor Johnson was putting before you his very interesting account of the obstacles that arise in the East, it occurred to me that it is useful to bear in mind always that the commission has just one test to apply in those matters, and that is the test of the public interest. It may be that railroad A would object to some combination involving railroad B, because that would enable railroad B to compete more effectively with railroad A and thereby put railroad A at some disadvantage; but under the standards prescribed by the act the objection could enlist the attention of the commission only to the extent of deciding which of those situations would be more in the public interest. Would it be more in the public interest to protect railroad A from the increased competition which would arise from giving railroad B what it asks, or would it be more

¹ What follows is an abstract of the discussion at the close of the First Session, at which Messrs. Hines, Blair, Davis and Johnson had previously made the addresses printed in the preceding pages of this volume. Mr. Waterman's contribution to the discussion is printed as a separate article, *supra*, p. 43.

in the public interest to give railroad B what it asks? So, the fact that there is this private difference of view between the different railroad systems is not conclusive, and the commission does not have to decide which of these private interests should prevail.

As I view it, the alternative and separate plan of unification through stock control or ownership has enabled the railroads, under the very carefully safeguarded provisions of the Transportation Act, to resume the development of systems through a process of evolution which had gone on ever since railroading started, and had continued until arrested by the Supreme Court's interpretation of the Anti-Trust Act. But this development can now proceed only as the Interstate Commerce Commission finds it to be in the public interest. Under these careful safeguards, the railroads may go a very long way toward reaching the ultimate design of the Transportation Act.

What was done through the process of evolution prior to the passage of the Transportation Act has, of course, greatly simplified the problem. What was done in the cases brought to your attention, where the commission authorized stock control or lease, has done more to simplify this situation; and at the same time, in cases where the commission has put in its order a reservation to that effect, the commission is in a position to modify those arrangements if later it is necessary for general consolidation. While it is complex and tremendously difficult to make, at a given moment, a consolidation map for the country as a whole, the progress of these controls through stock ownership and lease may lessen the need for taking the much more difficult step of trying to deal with the situation for the country as a whole at a single time through a general plan of consolidation. That again, I think, illustrates the great wisdom of Congress in providing not merely the consolidation method, which necessarily promises to be especially difficult, but also this other more facile method of control through stock ownership or lease.

ADVANTAGES AND DISADVANTAGES OF CONSOLIDATION

JOHN J. ESCH

Former Commissioner, Interstate Commerce Commission, 1921-28;

Former Member of Congress, 1899-1921

CONSOLIDATION or unification of rail carriers is not a new movement, but one that began in the middle of the last century. Prior to the Transportation Act of 1920, this movement was controlled exclusively by the states except for limitations as to interstate carriers prescribed by the anti-trust acts. Some state constitutions and state statutes prohibited the consolidation of parallel and competing lines; others did not. There was little or no uniformity. Nevertheless, great systems were established, main traffic centers were connected and numerous branch lines added.

There has always existed a feeling of prejudice against consolidations because of the fear of monopoly and a lessening of competition. Notwithstanding the regulation of rates, rules and practices by the federal and state commissions and our experience under federal control, this prejudice to some extent still exists. What is in the public interest and not sentiment should be the guide.

The key thought running through the Transportation Act is the establishment of a national system of transportation for continental United States. One of the means to this end is to secure uniformity in the matter of consolidations through powers granted the Interstate Commerce Commission free from the limitations of state laws and of federal anti-trust acts. Consolidation, or the acquisition of control of one carrier by another through lease or the purchase of stock, was not made compulsory under the act, the process being permitted to develop under the guidance of the commission in a normal way.

The act required the commission "to prepare and adopt a plan for the consolidation of the railway properties of continental United States into a limited number of systems. In the division of such railways into such systems under such plan,

competition shall be preserved as fully as possible, and wherever practicable the existing routes and channels of trade and commerce shall be maintained”.

After elaborate hearings the commission recommended to Congress that because of the impracticability of preparing a complete plan it be relieved from the duty of its preparation and indicated the amendments to the act it deemed desirable. No amendatory legislation has as yet been enacted, although the Parker and Fess bills, favorably reported at the last Congress, seek to remedy certain defects in the existing law. As these bills will doubtless be reintroduced in the present Congress a discussion of the advantages and disadvantages of consolidation is timely and profitable. For the sake of brevity I shall discuss the subject assigned to me under the following heads: legislation, size, traffic, operation, economy, short and weak lines and financial credit.

1. Legislation

It is generally conceded that consolidation of carriers under federal regulation is desirable. Federal incorporation is not now provided for nor is it contemplated. Carriers operate under state charters and are subject to the laws of the states granting them and of the laws of the states where they are authorized to do business. Under the commerce clause of the constitution Congress can regulate them as to interstate and foreign traffic. At present consolidations can be effected under state laws as was done in the case of the Nickel Plate, whose securities, however, were passed upon by the commission. To establish a national system of transportation a single control is necessary to build up a harmonious structure. To the extent necessary, state laws and constitutions and federal anti-trust laws must give way.

Prevailing opinion favors voluntary as against compulsory consolidations, as they permit of a natural evolution and obviate the grave constitutional question of the exercise of the right of eminent domain by one public utility to secure the property of another public utility.

To be in the public interest, legislation as to consolidation must further the unification of the hundreds of railroads, now separate entities, into a limited number of large systems,

regional or transcontinental in scope. In determining what is in the public interest the Parker and Fess bills provide that:

The Commission shall give due consideration to the maintenance of competition by the carriers and the prevention of any undue lessening of existing competition, the preservation and improvement of the service afforded by the necessary weak or short lines, the promotion of economy, the affording of better service, the securing of a simplified and more effective regulation of carriers, the ultimate establishment of a number of strong and efficient systems, well balanced within themselves and with other systems, and to such other factors as may be in the public interest.

While providing for the application of the standards thus prescribed, these bills seek to remedy the defects in the Transportation Act of 1920, which made genuine consolidation impossible because of the impracticability of formulating a complete plan, the delay in making valuations, the resort to the temporary expedient of acquisition of control through lease or purchase of stock, the possibility of prohibition of unification under state laws, and the failure to define the rights and remedies of dissenting stockholders.

As to the disadvantages of consolidation resulting from existing law or the proposed amendments thereto, it is asserted that to carry consolidations into effect it is or will be necessary ruthlessly to disregard the rights of the several states through whose charters the carriers now obtain their very existence. Some state constitutions and the statutes of most states prohibit the consolidation or merger of parallel or competing lines. In Texas a corporation is not permitted to operate outside the state. These limitations may now be ignored by federal authority. The artificial creatures of the state, while retaining the powers granted by the state, are allowed "to accept greater and additional powers from the federal government though thereby the corporation may violate the laws of its creation".

It is further objected that to carry out plans of consolidation the carrier may be relieved of the operation of the anti-trust laws in the discretion of the commission. This makes of carriers an exempted class and allows an agency of the government "to indiscriminately and at will set aside not only the specific law, but all restraints and prohibitions of any law or laws of the United States."

If voluntary consolidation fails, the alternatives are compulsory consolidation or government ownership.

2. Size

An inevitable result of consolidation is an increase in the size of systems. They must not be so large as to become unwieldy and incapable of efficient management and operation. They must not be so small as to make competition in traffic and service difficult or impossible with larger competitive systems. No arbitrary limit can be fixed. The territory to be covered, its traffic density, terminals reached, prospective tonnage, and the earning capacity of constituent parts are some of the factors to be considered. The test is not size alone, but ability to earn an adequate net railway income. This depends upon having the territory sufficiently large to secure a diversified traffic "to stand the shock of local business disturbances".

By the British Amalgamation Act of 1921 one hundred and twenty carriers were formed into four great systems, each occupying a separate territory. The largest of these has a route mileage of 8,000 miles—less than that of a dozen systems in the United States. Two of the largest systems in the world are the Canadian Pacific with about 20,000 miles and the Canadian National with about 22,000 miles, each under a single head. These are ably and efficiently managed and are in fact transcontinental in scope. By way of analogy the government is now aiding the states in building important trunk highways from coast to coast and from north to south with the assurance that such extended highways will knit the country together and facilitate traffic. In any plan so far proposed it is not contemplated to exceed much, if any, these Canadian systems. If Sir Henry Thornton, who gained his railroad experience in the United States, can successfully manage and operate 22,000 miles of road, we certainly have the talent here to do likewise. Harriman, the railroad wizard of his time, planned a transcontinental system in connection with the Union and Southern Pacific. Great systems require great leaders of outstanding executive ability.

The disadvantages of great systems lie in the fear that the greater the system the greater their potential monopoly. The lines of such a system stretched out from great trade centers

in all directions are, in the public mind, like the tentacles of an octopus grasping all within reach. Big business seeks to become bigger business to the disadvantage of the smaller unit, be it man or corporation. There is a point where bigness ceases to beget efficiency or economy. The larger the system the larger the personnel and the fewer the contacts between management and employees. The railroad cannot keep officials and employees under one roof. The latter are out on the road hundreds and even thousands of miles from central authority. Under these conditions the more far-flung the lines the more difficult it is to maintain loyalty and the proper *esprit de corps*. Although it is hoped that the recent Mediation Act will prevent strikes, should it fail to do so in a given instance, the larger the system the more widespread would be the disturbance.

3. Traffic

Consolidations to be successful must consist of systems so extensive, so self-contained, so diversified as to traffic, as to withstand the financial losses of widespread storms, droughts, insect pests, strikes and like disasters, so that scarcity in one part of the system may be made good by abundance in another. Each system should have an ample fuel supply along its lines and its proper share in the haulage of the output of factory, field and mine. Large and competitive centers and leading ports should be reached. These conditions can only be met by unifying many independent separately controlled corporations into a single entity for ownership and operation. In this connection natural routes and channels of trade constitute the lines of least resistance. Easier operation and better service will result. With large systems there will be greater facility of routing traffic over other lines. This will shorten the time in transit, lessen the number of transfer points and may result in lower rates. Fewer tariffs would have to be filed and there would be fewer defendants in rate and other cases.

As a disadvantage of large systems from the standpoint of traffic it is asserted that where only a few large systems compete for the output of our natural resources, farms and factories, there would be much less competition than where

many separate roads strive for the traffic. The creation of a few large systems might seriously affect the present trends of traffic and leave as mere way stations inland cities of size and importance. Cities as large as Kansas City and Omaha have already expressed fears to this effect.

4. Operation

As to the advantages of consolidation in the matter of operation, ex-Secretary Fisher states: "Consolidations should begin with the terminals". Our large and congested terminals are the throats of the bottle of freight and passenger movement. Joint terminals owned and operated by the carriers using the same, either directly or through a separate corporation, and the construction of belt lines, are suggested as suitable steps to avoid congestion and to speed up traffic. Larger use of trucks and container cars, particularly within switching districts, will also aid.

As already stated, large systems built up on the natural flow of traffic will result in better service and easier operation. They will make possible the lengthening of operating divisions, better loading, less switching and transfer at junction points, less back-hauling due to more direct routing and fewer empty hauls due to a well balanced traffic. They can better keep cars on their own rails, thus insuring better and more permanent repairs. They can consolidate shops, standardize their equipment, make a better utilization thereof and maintain a larger reserve of cars and locomotives. In many instances where they have two lines between important points, they can use one for passenger and fast freight service and the other for local and slow-moving freight or route traffic on the line of easier grade. By reaching most of the large traffic centers in their respective territories, they can intensify competition and build up many instead of a few communities, thus aiding shippers by extending their markets. They can stand competition better than small roads and systems because of this wider distribution which has a strong traffic appeal and because of their better organization. They can make important improvements requiring large capital expenditure, such as the Lucine Cut-off, under-river tunnels, big bridges, all expediting movement.

Many of the above advantages in the matter of operation are generally conceded. However, with systems ranging from 7,500 to 25,000 miles in length the condition of labor must be taken into account. The dismemberment of a road or its unification with a large system destroys preëxisting relationships. The old attachment is lost and a new loyalty must, if it be possible, be established. The larger the system the more difficult it is to create that *esprit de corps* which makes for efficient coöperation. While railroad labor organizations are now countrywide, their members know their own roads; they have been reared upon the right of way; they know the people they serve; they have acquaintance and contact with many of their superior officers including their president; they together constitute a real family. Enrolled with 100,000 and more other employees, under even the best of executive officers—whom they rarely, if ever, see and more rarely come to know—can they give the same devoted service as the few hundreds on the smaller roads? The human element cannot be overlooked. Should labor troubles arise, the smaller the road or system the less the disturbance in operation and the more localized the situation.

5. *Economies*

It is claimed that the economies made possible through consolidations largely justify them; that if the systems, limited in number, are well balanced with diversified and dependable traffic not dependent upon the condition of a single industry, continuity of revenue will be assured. Rate wars, which in the past have proved disastrous to the public, are infrequent now that the commission has the minimum rate-making power and pooling of traffic and revenues are under its supervision. The fewer the systems and the greater their equality of earning power, the less danger there will be of diminution of revenues due to rate cuts. With many small roads eager to secure needed revenue, there is a great temptation to get it by radical reduction in rates. With 1,900 roads operated by about 1,000 corporations the difficulty of stabilizing the rate and revenue structure is apparent.

Among the economies which would follow consolidations the following may be mentioned: The fewer the corporate en-

tities the fewer the executives and general officers and staffs, making for a lower overhead. With fewer and more simplified tariffs and with fewer carriers to account with there would be a material reduction in the clerical, operating and accounting departments. A more economical use of equipment would be possible. Cost of advertising and solicitation could be reduced. With the purchasing power in one agency, backed by greater credit, the cost of material and supplies, including fuel, would be lessened and discounts for cash secured. With fewer roads or systems there would in all litigated matters be fewer defendants and hence less expense; moreover, the work of regulatory bodies would be less onerous and expensive and decisions would be expedited. There would be an elimination of wasteful transportation. Passenger and freight trains could be discontinued in some instances. Solid train loads of given commodities could be operated at lower ton-mile cost. More direct in lieu of circuitous routes could be established. Time saved in transit would spell increased net to the carrier while giving increased satisfaction to the shippers.

President Powell of the Chicago and Eastern Illinois declared that:

consolidations will tend to produce economies because most of the traffic troubles today arise between connecting lines, especially since the passage of the Elkins Act. The consolidation of connecting lines from coast to coast and from the Canadian border to the Gulf will eliminate two-thirds of such disputes and substantially reduce the clerical work in traffic, operating and accounting departments.

Finally, strengthening the credit of a few great systems, equalized as far as may be as to earning capacity, will make possible larger additions and betterments required in the public interest.

In opposition to the claim for economies set forth, it may be stated that they are as yet more a matter of promise than of fulfillment; that they are uncertain and must be discounted because of the extra cost which consolidation may necessitate. Upon the passage of the British Amalgamation Act, Sir Eric Geddes prophesied that economies made possible thereby would in six or seven years amount to between \$100,000,000 and \$125,000,000 per annum. Up to two years ago only a fraction of this sum had been realized.

It has been found here as elsewhere that consolidations are not a panacea for financial, operating or traffic ills; that they "would create as many problems of management as they would solve"; that reduction of general supervision cost would constitute but a small fraction of the total costs; that competitive duplication of service between main terminals would not be affected (this latter condition can now be met in a measure by the pooling of traffic and revenues under the supervision of the commission under the Transportation Act); that traffic solicitation would not cease; that while the number of executives would be reduced, the number of supervisory or regional officials would have to be increased; that while there could be savings in management and operation as already set forth, these would be offset in a large measure by the increased cost in bringing the weak parts of the system up to the standard of maintenance and service of the main line and by the necessity of paying the employees of the same system the same standard of wages, and this too where the traffic over the weak part is not sufficient to compensate for service now being rendered.

It is the general hope that as a result of economies effected through consolidation rates may be reduced without a reduction of the net revenues. Some executives assert that the limit of reductions in operating expenditures has about been reached. If so, it is questioned whether the economies of consolidation, offset in a measure as they will be, will not weaken instead of strengthening the systems' credit with carriers not now earning $5\frac{3}{4}$ per cent.

With the present most efficient operation the country has ever known, why consolidate?

6. Short and Weak Lines

One of the difficult and most serious problems connected with consolidation is: What disposition is to be made of the short and weak lines? They cannot be disposed of by abandonment. If they could be recapitalized to a basis commensurate with their actual value they would be more readily absorbed. They should not be dealt with on a basis of nuisance value. As they make up over 20,000 miles of our total mileage and serve many communities, they must be fully and fairly considered.

One of the purposes of the Transportation Act was to take care of weak lines to the end that a national system of transportation might be effected, strengthening the weak, but not unduly weakening the strong. The commission in recent decisions has clearly indicated that, as a condition precedent to the grant of a certificate of convenience and necessity, the applicant carrier must give due consideration to the acquisition of short or weak lines connecting with it in the territory it covers, the terms and conditions, if not voluntarily agreed upon, to be determined by the commission.

All weak lines are not short, nor are all short lines weak. Some long lines are weak as a result of consolidations in earlier years. They were too ambitious, taking on too much territory, and have been unable since to improve their lines or strategic position. Some run counter to the trend of traffic in highly competitive territory, or their routes for through traffic are too circuitous. Some lines are weak because their facilities are poor due to low traffic density, or their traffic density is low due to poor facilities. Many short lines are weak because the natural resources they were built to transport have become exhausted.

Mr. Burgess, counsel for the Burlington, states that, "A common cause of weakness is the dependence of many short lines upon their connections, which are also competitive, to principal originating and exchange points". The above serious condition of many weak and short lines has in a measure already been given some relief by acquisition of their control under paragraph 2, section 5, of the Transportation Act by the larger connecting trunk lines. Provisions of the Fess and Parker bills will, under their plan of unification, afford still greater relief.

The disadvantage of consolidation as related to the weak and short lines lies in the fact that many will not be included in the large systems or if included will not be granted favorable terms. Performing a needed service and acting as feeders to the trunk lines, they seek for the right to exist. Even strong roads cannot thrive on traffic which originates and terminates on their own rails. They must depend upon their connections. Much more is this true of short lines.

Another alleged disadvantage is that large systems are to a

certain extent dominated by powerful financial groups whose main concern is the revenue-earning capacity of the system. They would not, under a plan of voluntary consolidation, have much, if any, sympathy for the weak lines whose absorption would dilute the earnings. For more complete relief, therefore, legislation not now enacted nor contemplated may be necessary.

Under voluntary consolidations, moreover, only those weak or short lines would be taken in which because of their location, potential traffic, easier operation or other reason, would make for the best administration, operation and net revenue. This would be taking the cream, leaving the residue without any just or proper disposition.

Consolidations of weak or short lines into large systems would require their revaluation and recapitalization, which would present great difficulties.

Some short lines are strong in traffic and revenues and wish to remain independent. Should they be compelled to lose their identity by being merged into a large system? Some weak roads by the discovery of natural resources or an increase in agricultural products in the territory they serve may next year become strong. They should be permitted to work out their own destiny.

7. Financial Credit

The main and essential purpose of the Transportation Act and of its proposed amendments is the establishment of better financial credit for the consolidated systems. Such credit will permit the sale of bonds at lower interest rates and allow larger issues of stock. The commission now has control over the financial set-up in consolidation matters. All issues of stocks, bonds and certificates are given the closest scrutiny. Over-issues are denied. Greater stabilization of carrier capitalization will follow. The confidence of the purchasing public will be increased. Better credit will permit greater expenditures and additions and betterments in the public interest.

It is conceded that consolidations may increase financial credit, but size has its limitations. In the industrial world many examples can be cited where great aggregations of plants

and capital have brought not greater profits, but failure. Great railroad systems may be made top-heavy as a result of a too ambitious program. Expected earnings may not be realized. Credit may be weakened and bankruptcy ensue.

Great systems require large amounts of capital. Such capital under recent and present conditions is secured through large banking houses or groups which determine in a large way the financial set-up without fullest regard to problems of operation. Consolidations encourage speculation. Small roads are family affairs, financed and controlled locally by those personally interested and acquainted with all the conditions affecting the roads' finances, traffic and operation. Initiative is not lost and the incentive to improve the service continues.

Under the authority granted the commission to fix the reasonable divisions of joint rates, fares and charges, the short and weak lines have in many cases been aided in securing increases in their revenues.

In addition to the advantages already presented one can be claimed against which there ought to be little or no opposition. Under the tremendous pressure of war needs in 1917 the country found that the 1,900 carriers in the United States could not meet the situation under individual operation. There were too many conflicting interests, too much divided counsel. By order of the president they were put under federal control and operated by him through the director general as a single national system of transportation. Whatever criticism there was as to this action, no other plan could have successfully carried us through the war.

In anticipation of such another crisis it would greatly simplify the situation and lessen the difficulties and possibly render future federal control unnecessary if all the carriers of the country were consolidated into a limited number of large systems with the responsibility of control centralized in a few hands.

I have sketched briefly and inadequately some of the advantages and disadvantages of consolidations. I wish to conclude by an expression of my own view. I believe now, as I did when the Transportation Act was in the making, that the consolidation of the carriers of the United States into a con-

tinental system is not only desirable, but necessary, if government ownership and operation are to be avoided; that such consolidation should be voluntary and not compulsory; that the limited number of systems to be created should be sufficiently large and of relatively equal financial strength and earning capacity so that there will be no undue lessening of existing competition; that each system should be of such size and location as to enable it to reach the main traffic centers and production areas within its influence; that each should have such a diversified and dependable traffic as to assure the stability of its revenue notwithstanding local depressions due to droughts, floods or other disasters; that each should have an ample fuel supply along its rails or within its territory; that each should have a capitalization based on valuation which would establish and maintain its credit and permit financing its requirements largely through the sale of stocks instead of bonds; that each system should take care of the short or weak lines connecting with and properly allocatable to it; that each should enjoy such rates, fares and charges as are just and reasonable and commensurate with the maintenance of an adequate system of transportation.

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INTEREST OF SHIPPERS AND FARMERS IN RAILROAD CONSOLIDATION

HONORABLE JAMES S. PARKER
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1. Consolidation not a New Thing

THE term "railroad consolidation", like many other popular phrases, has both a popular and a technical meaning. In the popular sense, railroad consolidation is any form of unification where the result is a centralization of control over different operating units formerly independent and the introduction of uniform policies, practices and operations. In a more technical sense, railroad consolidation proper means that a single corporation, whether new or old, owns as well as operates the railroad properties involved.

Railroad consolidation, in all interpretations of the term, is not a new thing. We are all aware that practically all the great systems which are now in operation are the result of some form of unification. In fact, this process of combining different lines of railroads has been a continuing factor from the early years of railroad development.

One of the first laws enacted by the federal Congress which might be termed a railroad unification law was passed in 1866. This law said, among other things, that:

Every railroad company of the United States . . . is hereby authorized to carry . . . all passengers . . . freight and property on their way from any state to another state . . . and to connect with the roads of other states, so as to form continuous lines for the transportation of the same to the place of destination.

No one will question the statement, I feel sure, that the early unifications of carriers, whereby local roads were joined together to make the great through systems from trade center to trade center with unity of operation and equipment, were of tremendous benefit to the shippers of the country. I feel sure also that no one today believes that these small local properties

should be separated from the systems to which they have been joined or that such an effort would be in the public interest.

Railroad consolidations were progressing rapidly up to the point where they were stopped by the Sherman Anti-Trust Law and the Clayton Act. I shall not stop to discuss the reasons for such legislative action. Its justification is generally conceded. Nor shall I pause to discuss facts as to the change in the public attitude toward the question of railroad consolidations as expressed in the Transportation Act of 1920. My purpose in calling attention to these facts is to show that it was a legislative act and not an economic principle that interfered with the progress of railroad consolidations. I only add that it does not seem reasonable to believe that the full benefits of unification of railroad property were attained when legislative action practically froze the situation.

Furthermore, it would seem reasonable to believe that the railroads, like other kinds of business, should be permitted to seek that size and type of organization which will enable them to serve the public best. Railroad management ought to be allowed such freedom as is necessary, under proper regulation and supervision, to realize economies of operation and betterment of service through such consolidation as will enable them to operate on the most effective basis.

2. Why I Support Legislative Action for Voluntary Consolidations

It is with the belief that the public should have adequate and efficient transportation service at the lowest possible rates and that one means to this end may be found in railroad consolidation, that I have given my support to this movement in Congress. It is on this basis that I have introduced into the House a measure now generally known as the Parker-Fess Bill.

The public has the right to demand of Congress that it establish a system of regulation which will give each community the transportation service upon which its life, its growth and its development depend. We have a system of regulation. Unless that system is made more effective, however, we shall be confronted with a demand for greater governmental aid and ultimately government ownership. It is my opinion, and I am confident that it is the opinion of a large majority of the

people of this country, that private operation of our transportation agencies under public regulation should be continued as the permanent policy of our government.

It is not supposed that consolidation will afford a panacea for all the ailments of our present system. I am confident, however, that voluntary consolidations will mark a decided step forward toward the ultimate satisfactory solution of our transportation problem. It is because of such a firm belief that I have lent my support to legislative action for voluntary consolidation.

3. What May Be Expected from Voluntary Consolidations

I shall leave it for others to discuss the practical and legal reasons why further legislative action with respect to railroad consolidation is required. Mere reference will be made to the fact that the last two presidents of the United States urged legislative action to permit and encourage railroad consolidation for the benefit of the people, to the fact that the Interstate Commerce Commission for several years has urged Congress to relieve them from the making of a comprehensive plan for consolidation, and to the fact that the Association of Railway Executives, the American Short Line Railroad Association, the National Industrial Traffic League, the Chamber of Commerce of the United States and the National Association of State Commissioners have likewise indorsed legislative action of this character.

I turn my attention to the question of what may be expected to be gained from railroad consolidation.

Protection of Public Interest. The foundation of every important piece of federal legislation should be the promotion of the public interest. In this matter of legislative action for voluntary railroad consolidation the protection of the public interest is paramount. Consolidations should not be permitted solely for the sake of consolidating. Authority should not be given merely to satisfy the desire of human nature to attain gigantic size. On the contrary, consolidations should be authorized when, and only when, they are in the public interest. This means that the public will not be deprived of any of the advantages which it now possesses but that it will be assured of benefits as a result of such consolidation.

Thus, the first paragraph of Section 202 in the Consolidation Bill which was before Congress at its last session declared :

The unification of carriers or of property of carriers, through any method of procedure provided for in this title, is hereby authorized in any case in which, in the opinion of the Commission, such unification will promote the public interest.

The public interest, then, being the guide for consolidation of railroads, it will be of interest to see what is proposed as the test of public interest. The same section of the bill to which I referred above continues as follows :

In determining the public interest the commission shall give due consideration to the maintenance of competition between carriers and the prevention of any undue lessening of existing competition, the preservation and improvement of the service afforded by the necessary weak or short lines, the promotion of economy, the affording of better service, the securing of a simplified and more effective regulation of carriers, the ultimate establishment of a number of strong and efficient systems well balanced within themselves and with other systems, and to such other facts as may be in the public interest.

It will be observed from this section of the bill that the tests as to whether or not a proposed consolidation will be in the public interest are :

1. The maintenance of competition between carriers.
2. The preservation and improvement of service, especially by the necessary weak or short lines.
3. The promotion of economy.
4. The affording of better service.
5. Simplified and more effective regulation.
6. The establishment of strong and efficient systems well balanced within themselves and with other systems.

There is then left to the discretion of the commission consideration of such other factors as may be in the public interest. I propose to touch briefly upon all these points for the purpose of showing particularly why the shippers and farmers of the country should be interested in this matter of railroad consolidation.

Competition to be maintained. It is not intended by any proposed legislation to eliminate competition between the carriers. On the contrary, competition is to be maintained.

Obviously, however, consolidation of railway properties on any considerable scale can not take place and still retain absolutely existing competition. The aim is that there must be competition after unification if there is competition before the unification. Competition between two strong carriers after a unification, it is believed, would prove much more effective than existing competition between a strong and a weak carrier. The public interest, therefore, will be materially promoted if in such case existing competition is replaced by effective competition between carriers of substantially the same strength.

Proposed provision is made for any undue lessening of competition, but it is only undue lessening that the commission must prevent, on the ground that if the public interest unquestionably requires some lessening of existing competition such lessening will not be "undue". Such competition as involves unnecessary and wasteful duplication and thus increases costs may be considered detrimental to public interest and, therefore, may well be eliminated. The real advantage to the public of substantial competition, it is believed, can be gained only through unification resulting in competitive systems of approximately equivalent earning power, financial strength and efficiency.

Preservation of necessary short lines. There are carriers in different parts of the country rendering a necessary service to the communities along their lines, yet for one reason or another not able alone to afford adequate transportation service. Some of these are short lines which are unequal in the competitive field to their financially strong rivals. These are generally referred to as the "weak" or short lines.

It is proposed that the commission be required to give due consideration to the preservation and improvement of the service afforded by this group of carriers. In fact, this is to be one of the tests of public interest.

The weak line problem is undoubtedly one of the most serious problems now confronting us. A large number of weak or short lines must continue to be operated in order that all communities may be afforded transportation service. Continued abandonments will produce disastrous results to those communities which have developed in reliance upon the con-

tinued operation of such lines. While it is not expected that unifications will remove entirely the weak line problem, it may be considered a certainty that a very substantial percentage of the weak lines by becoming parts of strong and efficient systems will not only be preserved but will have their service substantially improved.

Promotion of economy. Another test of public interest in which shippers and farmers are vitally interested is the promotion of economy in operation by the rail carriers. The evidence that has been collected through hearings before Congressional committees is convincing that real economy will come from unifications.

While there does exist much difference of opinion as to the effect, in dollars and cents, of the economies in operation that will be realized, past experience shows beyond a doubt that in addition to superior service the shipping public will be benefited by resulting economies of operation. The detailed sources of economies should be discussed by practical railroad men. It is obvious, however, that large systems can make more economical use of their equipment because of the fact that a small road does not have sufficient traffic or sufficiently diversified traffic to make the most effective use of all the equipment required to handle peak loads and of the different types of cars required to handle different commodities. It is likewise obvious that as a result of unification there will be more direct routing of traffic and less back-hauling of freight, that direct lines will be available for commodities demanding fast service, that the cost of switching will be reduced to a minimum, that methods and equipment and practices will be standardized, that a substantial and forceful purchasing power will be concentrated in one agency and that shops and equipment will be utilized to the maximum extent.

Unification will result in the strengthening of credit facilities. In consequence, there will be economies effected through additions and betterments, through better equipment and through improved roadbeds.

I want to go a step further. The price that the carrier pays for the money that he borrows is reflected in the rates that the shippers, be they farmers or manufacturers, pay. The public, the shipping public, is just as much interested in the rate that

a railroad company has to pay for the money it borrows as the railroad company itself, because in the final analysis the public furnishes all the money to pay the interest and to run the road.

In all of these results, the shippers of manufactured goods, of raw materials, and of farm products are directly interested. It is essential for the producer of perishable products—requiring adequate facilities promptly at the time these commodities are ready for shipment, requiring dependable, fast schedules direct to consuming markets—to be assured that such service will always be available, that switching and transfers will be reduced to a minimum and that his commodities will be delivered at the consuming markets in the shortest possible time and in the best possible condition.

The late Senator Cummins, who was greatly interested in the question of consolidation, estimated "that the savings from proposed consolidation would be in dollars and cents from three hundred to five hundred million dollars annually." In one of the proposed mergers now pending before the Interstate Commerce Commission, evidence was introduced to prove that the aggregate annual savings through economies would be at least ten million dollars a year. How accurate these figures may be I do not know, but I am convinced that there will be substantial savings through economies of operation and important savings to the shippers and farmers of the country from resulting improvement in the service.

Better service. As has been indicated before, the unifications of past years have admittedly resulted in a better service from a continuous operation over longer lines than was afforded by operation over a series of short lines. Such opportunity for improving transportation service will again be offered by further consolidation. An extensive system of railroads is in a far better position to make direct and fast shipments than would be a number of independent shorter lines. Such a system would always have a sufficient number of cars of the proper type available to meet the shippers' demands. It would be able to give regular, adequate and satisfactory service. There would be a larger number of solid trains to and from large trade centers and important gateways. The operation at terminals in large centers would be greatly simplified. Junction points would be reduced. Transfers would be elimi-

nated. As a very important consequence, the failure of a crop or the depression of a single industry would not affect so severely the revenues of a large system as it would the revenues of a smaller system whose service was very largely confined to the areas directly affected by such failure or depression.

Even if no substantial economies in operation resulted from unification the vast opportunity for improvement in service would justify the support by shippers and farmers of the movement to secure the consolidation of the carriers under proper supervision and safeguards.

Simplified and more effective regulation. At present there are about 1,900 railroad owning companies. The facilities are operated by about 1,000 separate companies, each of which has its own individual problems before the state commissions and the Interstate Commerce Commission, and these commissions must give consideration to each of them.

It would seem obvious that there could be a more effective regulation of the carriers if the number of owning and operating companies were reduced. For example, no system of rate-making today can be based upon the condition of an individual railroad. Rather it must be based upon the condition of the railroads as a whole within a given competitive territory. So long as the units of our transportation system are so greatly lacking in uniformity as at present, it is obvious that no uniform result can be obtained. To emphasize this point I wish to call attention to the fact that 172 of the Class 1 railroads earned 96 per cent of the total of all the revenue earned by all the railroads in this country. This leaves 800 railroad companies with an income of but 4 per cent of the total.

Here, again, extended unification offers the only means other than absolute government ownership by which railroad units of a substantially uniform character may be created. It is well known that public regulation under existing conditions is extremely difficult. The complexities of regulation are constantly increasing. If we can not make it more effective, efficient and fair, it may be that public regulation will fail. If it fails, the continuation of private ownership will become impossible.

Here again is a question in which the interests of the shippers and the farmers are vitally involved. It is assumed that

they desire to see a continuation of private ownership and operation of our rail carriers. It is certain that they desire the most effective, efficient and fair regulation that is possible.

Strong, efficient and well-balanced systems. The aim of railroad unification is the establishment of a limited number of systems which can render and which will continue to render the public adequate service at rates which are reasonable to the shipper and which will yield the carriers a fair return upon the fair value of their railway properties. Such systems must be strong and efficient and well balanced within themselves and with other systems.

By a "strong" carrier is meant one that is able to obtain the necessary funds for additions and betterments and equipment at the lowest possible cost. It is one whose financial standing is unquestioned.

By an "efficient" system is meant a system neither so large as to be unwieldy or unmanageable nor so small as not to be able to secure such economies as may be derived from large scale operation. It is a system that can make the best possible use of its rolling stock, yards and terminals, so as to avoid congestion on the one hand and idle facilities on the other. In short, it is a system that will be in a position to meet the transportation demands made upon it at the lowest possible cost.

A system well balanced within itself is one large enough to justify the necessary operating overhead costs, such as the employment of the most efficient operating officials, traffic officials, supervisors, etc.; one where the different functions of management may be so separated as to secure adequate and effective attention without becoming top-heavy; one that reaches such points as will give it a reasonable opportunity to originate well diversified traffic so that depression in a single industry will not too greatly affect its total traffic.

A system well balanced with respect to other systems is one fully able to give service comparable to that afforded by its competitors and one able to hold its own with other systems serving the same territory.

There is perhaps no more important factor in the welfare of shippers and farmers than the competition in transportation service of such strong, efficient and well balanced railroad

systems serving all sections of the country. If our theory of regulation is sound, namely, that rates on competitive commodities over competing rail lines must necessarily be uniform and that competition must be shifted to service, the proposed unifications of carriers resulting in such systems as I have described will bring the best possible service on the basis of just and reasonable rates.

The backbone of our transportation system today is the rail carrier. Congress has adopted the policy of preserving and sustaining in full vigor this service. But the rail carriers are faced with difficult and complex problems. Divided as they are to-day into such a great number of units, with such great variety of conditions and such a lack of uniformity in their financial, traffic and operating aspects, it would seem natural to believe that most of the fundamental problems facing the rail carriers could be met, or at least greatly simplified, through the process of unification.

If this is true, then the shippers and farmers of the country would unquestionably be greatly benefited by any such Congressional action as would promote railroad unifications under careful supervision and adequate safeguards.

It is because I have a firm belief that these important benefits will result from proper rail unification, because of my firm belief in the desirability of continued private ownership and operation of our rail carriers, that I have been willing to support in the public interest the movement for railroad unification.

CONSOLIDATION FROM THE RAILROAD EMPLOYEES' VIEWPOINT

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RAILROAD consolidation presents many intricate economic problems. As none of the tentative plans of consolidation so far proposed has made specific provision for the protection of the rights or interests of the railway employees, and in the absence of knowledge as to how they would be treated, it is most difficult, if not impossible at this time, to expect the railroad labor bodies as a whole to view railroad consolidation with enthusiasm until they know more definitely what will be the results when consolidation takes place. I prefer, therefore, to approach this subject more from a personal viewpoint, by attempting to point out some of the difficulties which may confront any form of consolidation, rather than to propose or indorse any plan of consolidation.

The claim of the advocates of consolidation is substantially that the predominant advantage of consolidation is a general coördinated system of transportation, which preserves competition of service among the consolidated lines. This advantage comprises the requirement of maximum accommodations to the territory which the competing systems are to serve. If properly approached, this objective, in my judgment, can be accomplished far more advantageously under private ownership and management, with public regulation, than by public ownership or public operation. No plan for government ownership or operation of which I have knowledge seems desirable. On this phase of the railroad problem there are differences of opinion, and it may be that at some future time an experiment in government ownership or operation will be undertaken. Such an experiment appears most remote. It is quite probable, however, if those interested approach the objective of consolidation of existing agencies of transportation in the proper spirit and at the proper time, with due regard

for all interests, including labor, that such an event may materialize at some time in the distant future.

The greatest obstacle standing in the way of unification into large competing systems is difficulty of arranging these systems in such a manner that they will satisfactorily absorb the weaker branch and feeder lines. Competition of service, generally, must be preserved; it is beneficial to our transportation structure.

Branch and short lines usually furnish the essential transportation facilities for the communities they connect. To leave these lines and the communities they serve out of the general plan of consolidation would be a serious mistake. These feeder lines should, and in fact must, be given consideration in any general plan if we are to be assured of success. These lines in their present position may not be dividend payers, as separate units, because of existing circumstances of management and operation. Nevertheless, in the general transportation system of the country they must be considered as highly important agencies for the carriage of goods.

From an employee's standpoint the short line question is one of our most serious problems. The employees of such lines are competent. They contribute their share in the handling of passengers and freight. They are entitled to fair wages and good working conditions to the same extent as those employed on the larger lines. Under the separate unit method of operation now existing, the managements are generally confronted with improper returns on investment. Likewise, the men are, in many cases, deprived of adequate wages. Usually less trouble is experienced in adjusting properly the wages and working conditions on the large lines than on the small ones.

It has been thought by many, and honestly so, that the recapture clause in the Transportation Act was a great forward step economically. It may have its good features; at least, the theory upon which it was built had a ring of plausibility. But really, has it gone very far in solving our transportation problem? Has the operation of the recapture theory actually permitted a resultant reduction of rates? Has it contributed anything toward a stabilized rate structure, or are there hopes that it ever will? Is it making the weak lines any stronger?

Is there one among us who would advocate the application of this principle to individuals or to business concerns other than transportation agencies? I do not think so.

The recapture clause may be progressive, if it is progressive to take from the strong and lend to the weak. It seems to me that charity is not what we are seeking. To my mind, common justice is the prime essential. I believe it better to have an inclusive plan of unification, comprising provisions whereby the weak railroads would be coördinated with the stronger systems. This plan must necessarily be complemented by a rate structure which would remove any need of charity. Should we not view the question in its broadest aspects and approach it from the standpoint of the general transportation system rather than attempt to deal with the separate units as particular problems?

I realize that had anyone advanced such a theory prior to the period of federal control, before we had the benefit of that and subsequent experiments, his patriotism, if not his sanity, might have been questioned. The old adage, however, still seems to hold good: "Live and learn." If we progress, we shall have to change opinions to meet the changed and changing conditions of mankind. No greater example can be found anywhere than that of our own experiment in government in the United States.

In consummating to the fullest extent a plan whereby the large systems of railway in a given territory would be required to take over the feeder or small lines in a section, we may be confronted with numerous legal as well as other obstacles. I believe, however, that public sentiment is rapidly crystallizing in the direction of economic unifications.

I do not doubt, also, that labor will give serious consideration to this problem, if given an opportunity to do so, and if given assurances that the rights and interests of railroad employees will be safeguarded. It seems, however, that common justice demands that the rights of the employees be considered as seriously as any other factor entering into the railroad consolidation problem.

Railroad labor has the gravest possible apprehension about the full protection of employees' rights to employment when consolidations take place. In fact, the brotherhoods are more

seriously alarmed about this particular question than almost any other involved in the problem. For example, the Brotherhood of Railroad Trainmen in convention assembled reaffirmed the position previously taken by the board of directors of that organization, whose views had been presented to the committee of Congress during consideration of a former consolidation plan: "That in the consideration of plans for the consolidation of railroads, the carriers ought to be consolidated in such manner as will safeguard to the greatest extent the seniority, contractual and other rights of the employees on the properties."

Labor, of course, will have to insist that the rights of the employees be fully protected. It is proper and only just that this position should be taken. It could never be conceded that, simply because a property passed from the ownership or operation of one person, firm or corporation to another, the men employed on such absorbed property should be displaced by employees on the property absorbing the line or lines. This is not an insurmountable problem by any means, but it is one which must be given full consideration, because it will have, either directly or indirectly, a serious effect upon nearly two million employees and their families. The procedure usually followed in mergers of properties is to preserve the contractual, seniority and other rights of employees on the merged properties. They may be expected to insist strenuously upon the preservation of all their rights enjoyed on the respective parent properties when mergers and consolidations take place.

Losses of employment, removal of homes and other probable consequences of consolidating facilities for the purpose of effecting economies in the production of service may result in serious and perhaps needless injury to railroad employees. Therefore, any plan of consolidation which does not fully take into consideration these probable resulting injuries will undoubtedly meet with the opposition of railroad employees.

After all, one cannot escape the fact that improved transportation facilities are the chief needs and most vital assets of the nation. While the general coördination of our combined agencies of transportation is not a part of the subject under discussion at this time, yet it is a factor with which we

will shortly have to deal. I am quite sure that the railway employees may be depended upon to meet this phase of our transportation problem, when it is reached, in a broad-minded way.

Attention will undoubtedly have to be given to joint rail, water, air and highway traffic arrangements in keeping with the general development of transportation. Some progress has been made in the direction of unification of rail, air and highway service and it seems not improbable that water transportation as well will have to be included with the others. At least, regulation would be simplified and less confusion would ensue under a coördinated plan. When that time comes the wise course to pursue is to approach the question with the same breadth of vision now required in dealing with railroad consolidation. Some existing laws may have to be repealed and the public attitude perhaps changed. But if we really are sincere in our claims for a great coördinated system of transportation, we must view it from the standpoint of what is in the interest of the general welfare. If our railways and their efficient corps of employees have proved the most successful of any known agencies in the handling of commerce, it is only reasonable to assume that they may be relied upon, with equal assurance of success, to assist in working out a plan whereby there can be operated rail, water, air and highway systems under unified direction.

One must realize when such a plan is proposed that opposition will develop. It has in the past in other endeavors. When the general problem of unification is approached from the broad standpoint of giving the country transportation of the most efficient character, a sound, coördinated structure and service adequate to the economic requirements of distribution, both foreign and domestic, opposition perhaps will fail. Such considerations must comprehend protection of investment, income, rates, service and labor. We must face the problem with an open mind, which can be done only when all factors and agencies are considered.

American labor now as in the past may be depended upon to do its share in assisting in this development. Railroad employees are even now facing a serious economic situation in the matter of employment. They, in common with others who

must depend upon salaries or wages for a livelihood, will continue to help find a solution to the problem of change of employment, if given an opportunity. None desires to stop progress or to take any step which will militate against our general prosperity. These men, as must be realized by all, are approaching a crisis when so many of them are being displaced yearly. Means must be found by which they can follow the business which is being diverted into other channels, or they must be prepared for entry into other fields of employment.

A serious mistake will be made if railroad employees are not permitted, as far as possible, to enter the service of the new agencies of transportation which are now rapidly springing into use. At least, those who can qualify for this new service should be permitted to do so. It is not common justice, in such situations, to take men from other walks of life and place them in the transportation service, forcing the transportation men out of employment or compelling them to seek employment elsewhere.

Then, too, a liberalization of policy should be followed with regard to men going from one railroad to another. I do not wish to be understood, in this connection, to be advocating a return to the old-fashioned "boomer" or "tourist" policy, where men would leave the service of one railroad to enter another as a pastime or for the purpose of seeing the country; but I mean that those who are displaced by the introduction of larger power and other changes should be permitted to go to other points where their services may be utilized or to go into the service of transportation systems other than rail, with preference for employment over new men outside the transportation field.

In other words, let us join hands with the general public, of which railway labor and their families represent approximately nine per cent, in helping to find employment for those who accepted railroading as a calling in life. Let us remember that these men have done a splendid job in helping to build up these transportation systems. They undoubtedly may be depended upon to do a first-class job in further perfecting and coördinating our future greater transportation systems regardless of what methods may be employed in transporting passengers and freight. Give them the opportunity to stay in

the transportation service, in preference to employing new men.

In the spring of 1923 the railway executives of the United States determined upon what they termed a comprehensive, concerted and united program, the objective of which was to have the right car at the right place at the right time. In that same year efforts were begun towards bringing the public more into the daily operation of our transportation systems, by the organization of shippers' regional advisory boards. Approximately three-fourths of a billion dollars within one year, to be supplied annually running over a period of years, was made available for railway investment. The railroad employees met this situation by increased efficiency and production. The public coöperated, as has been stated, by the appointment of regional advisory boards, which have done most splendid work by assisting the carriers to have the right car at the right place at the right time. Consequently, with the lapse of approximately six years, a wonderful showing has been made, which exemplifies what may be accomplished by proper coöperation and coördination of activities. Car-loading has been increased, trains handled with promptness and dispatch, and better service provided.

The same spirit of coördination and coöperation should be given in the matter of railroad consolidation.

To give you briefly the contribution made by the railroad employees to this program of rehabilitation of the transportation systems of the country, the following facts are presented:

Between 1913 and 1928 the index of traffic units handled per employee rose over forty per cent. Approximately half of this increased efficiency occurred during the last eight years of the period. In other words, between 1920 and 1928 the amount of work accomplished per employee grew one-sixth. During the same period, since 1920, the ton-miles of revenue freight carried on our Class 1 systems rose from 410,306,000,000 to 432,985,000,000 ton-miles, while the tonnage of revenue freight originating grew from 1,255,000,000 to over 1,286,000,000. The number of employees on Class 1 railways in 1920 totaled 2,022,832; in 1928 we find this increased tonnage handled by only 1,656,289 employees. This shows an increase of 12,681,000,000 ton-miles of revenue freight carried with a decrease of 356,543 employees.

Another striking fact is the decrease of labor costs. The compensation of the employees on our Class 1 railways in 1920 was over \$3,681,800,000. In 1928, despite the great increase in freight movement shown above, the compensation was less than \$2,818,750,000, or a total reduction of over \$863,000,000 in labor cost, or more than twenty-three per cent.

Let us dissect these figures a bit further: the total number of transportation employees in 1920 was 355,579. In that year these employees received a total compensation of more than \$861,717,000. In 1928 we find that the transportation employees on our Class 1 systems had been reduced to 310,817 and their total compensation reduced also to less than \$763,690,000—which means a reduction of more than seven per cent in the number of transportation employees and more than eleven per cent in their total compensation.

So, this index of work accomplished by the employees is strikingly significant. Just consider that with their increased productivity between 1920 and 1928, with their relative as well as actual decreased compensation during the same period, there has been a greater amount of work done for the carriers, with fewer men and smaller wages. This is not only a worthy contribution made by the railway employees to the railway management; it is a public service not soon to be forgotten.

Since 1920 railway employee productivity has increased over one-sixth. Furthermore, at no time since the war have our transportation systems begun to approximate so closely the maximum return permitted under our Transportation Act. Faith in our transportation structure was completely expressed by our railway executives. This faith was further expressed by the whole-hearted public coöperation of the thirteen shippers' regional boards. It was splendidly exemplified by the marvelous increase in efficiency and coöperation on the part of the employees. Consequently, in considering consolidations this record will undoubtedly be reviewed and in all probability will be used as an argument both for and against the necessity of any plan proposed.

In this great intricate problem of consolidation these three factors must at all times be uppermost in our minds. No system of consolidation should be considered which would in any way mitigate against the further results that these three factors

alone may be able to accomplish in fostering transportation. They are the prime essentials to the upkeep and to the up-building of our general transportation structure. Let me again repeat that public coöperation first, finance and management second, and whole-hearted employee coöperation and efficiency third, are the prime essentials in any transportation structure.

My experience in nearly thirty years of close association with railway officers and employees, including more than twenty years in a representative capacity, leads me to the conclusion that no other group in our national life gives more nearly perfect service than the railroad men. No other group in any capacity in any part of the world can better their record for efficiency and coördinated activities.

Try as we may, it is difficult to separate management and employees in the railroad industry. Therefore you will find that the viewpoints of the men and of the management are usually more completely in accord on all of the questions which generally affect the railways of the country than is the case in other industries. This policy should not be varied in the consideration of railroad consolidation. The employees should by all means be called into council in its consideration. The reason is plain, because their interests have been in common for so long and most of the officers have come up through the ranks and understand the problems of employees from personal experience. Then, too, from the lowest employee to the highest official they are taught that the first consideration of each is to serve the patrons of the company and to give efficient service to the transportation business in which they are engaged. All understand from the moment of their entry into the service that faithfulness to duty is the prime essential, if they would remain in the service, and that if they do their duty they will be protected in their employment.

Why should not the same spirit prevail now as in the past? You may expect the coöperation of the employees in solving this or any other problem which may arise and which has as its object the betterment of our transportation service, if they are only given an opportunity to coöperate, but their interest should in no manner be disregarded. Investment, management and employees, jointly, should do their full share in the matter of

railway consolidation if there is a real need for such a plan. On the other hand, each is entitled to full justice at the hands of the public that each so efficiently and faithfully serves.

I am advised that the railway labor executives are giving most careful consideration of the problem of consolidation and will in the near future be in a position to give their views concretely. Until such a program is completed and announced, it would be only a conjecture as to what form of consolidation, if any, will be favored. It is safe to predict, however, that the problem will be viewed in the broadest sense but with a strenuous insistence that the railroad employees are an important factor in transportation development and as such should have proper consideration in the final decision.

Finally, may I not impress upon you that it is the firm conviction of the railroad employees that their welfare and the welfare of their families must be dealt with properly, and their interests protected, in any plan of consolidation, not only from an economic standpoint but from the viewpoint of humanity and justice to a class who are contributing their full share toward the advancement of our great civilization and prosperity.

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THE RELATION OF THE SHORT LINES TO RAILROAD CONSOLIDATION

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THE term "short line", when applied to a part of our railroads, is not only very indefinite as to its meaning, but in fact it is a misnomer, and hence results in much confusion.

Among the great number of steam railroads in this country, there are approximately 700 which compose the class usually referred to as "short lines". Notwithstanding that large number of roads, they are frequently spoken of with derision, even by persons who should know, if they do not, that they constitute a very substantial part of our railway facilities and render services that are necessary, very necessary, in our transportation system.

The importance of this class of roads, located as they are in every section of the United States, is clearly indicated, if not demonstrated, by the fact that they own, and / operate as a minimum, approximately 50,000 miles of track. Senator Cummins, than whom there was no greater authority on the subject, advised Congress that this class of roads operated at least 70,000 miles of track.

It would seem to be a simple proposition to classify these roads on a mileage basis, and that is usually done by persons who are not familiar with the facts and conditions. The mileage of a road of and by itself cannot be used as a basis for classification, notwithstanding the attempts of Congress, of the Interstate Commerce Commission and of other official bodies so to use it. As an illustration of the impracticability of such a standard, I shall name two roads, both of which are surrounded by conditions that definitely place them within the so-called "short line" class: one, the South Manchester Railroad in Connecticut, has two miles of track, whereas the other, an extreme case, the Kansas City, Mexico and Orient, recently

acquired by the Atchison, Topeka and Santa Fe, has 735 miles of track in the United States.

During the last few years I have had the responsibility of speaking officially, in a general way, for this class of roads and have been called upon by the Interstate Commerce Commission, and by one or more committees of Congress, to give a definition of a "short line". Responding, I have stated that the term "short line" means a railroad that is "short in mileage or short in revenue or short in both." That definition when given was, in each instance, received and treated as facetious, hence it became necessary to demonstrate that I was not only serious, but sound in my answer. As an example, I called attention to the fact that if mileage is to be the only measure or standard of a "short line", such roads as the Richmond, Fredericksburg and Potomac with its 114 miles, Atlanta and West Point with its 91 miles and Western Railway of Alabama with its 130 miles, would be classed as "short lines", although they have all the elements of, and are, trunk lines in fact.

On the other hand, if mileage alone is not the determining factor and the want of adequate revenue is also given consideration, such roads as the Georgia and Florida with its 402 miles, Missouri and North Arkansas with its 335 miles and, as heretofore stated, the extreme case of the Kansas City, Mexico and Orient, together with many others similarly situated, fall within the "short line" class. The fact is that special adverse conditions surrounding these roads and a large number of others, caused largely by their shortage in revenue, differentiate them from main or trunk roads and leave them in the "short line" class.

To obtain a clear understanding of the consolidation question for the purpose of this discussion, one should divide the roads of the country into two classes—one the "strong" and the other the "weak." If they are so separated it becomes at once apparent that the weak roads are vitally interested, more so than the strong, in consolidation of all into a limited number of systems.

During the extended discussion of the consolidation problem in Congress, before its committees, before the Interstate Commerce Commission, in the public press and other forums, much has been said about the injustice of requiring the well con-

ceived, well planned and well operated systems to acquire and include the weak roads. That contention has very little, if any, merit. It not only ignores the great public interest in preserving the large mileage operated by the weak roads and the valuable transportation services which they render, but is largely fallacious for the reason that it gives undue credit to the strong roads, especially in assuming most of them to have been well conceived and planned as systems. The facts are that only about a half-dozen of the existing systems can by any stretch of the imagination be said to have been conceived and constructed as such. The great majority of the existing systems were not originally conceived as such, but like Topsy they just "grow'd." Practically all of them are made up of roads that were originally constructed as separate and independent so-called short lines, the great majority of which could not be successfully continued as such. Most of these were either forced through bankruptcy or acquired largely on that basis, and merged or consolidated with other like properties, thereby becoming not only component parts of the so-called system, but, in the aggregate, the system itself.

More than six thousand such separate and independent pioneer roads of the so-called short line class have been consolidated into and now constitute the great majority of existing systems. These roads when constructed were intended to develop and serve limited territories just as the great majority of like roads now in existence were intended to do. A very large percentage of such roads failed financially for the reason that operating alone they could not obtain necessary revenue. Like the proverbial single stick, they were easily broken standing alone, but gained strength as and when combined and consolidated. They now stand out in all of their combined strength, and vociferously claim that they were well conceived and well planned, and that hence they must be permitted to take only such additional roads as they may want, leaving all others to shift for themselves, regardless of the disadvantage thus inflicted upon the remaining roads, and of the further fact that the public will thereby be deprived of transportation facilities which it needs.

With a view to proving my statement that the great majority of our systems are composite ones, I give the following

illustrations, and they are indicative of others. The Pennsylvania system is one of our strongest. It has acquired and included more than 600 independently constructed and operated pioneer roads, few if any of which were conceived or constructed for the purpose of becoming a part of that system. The New York Central, another of our strongest systems, has absorbed and included in its system more than 400 of a like class of roads. The Baltimore and Ohio, another one of the strong carriers in the Eastern territory, may be classed as a system that was conceived and planned, if that can be correctly said of any system in the East, and yet it has acquired and merged into itself more than 250 separately constructed and operated roads. Like conditions exist in all sections of the country, and I do not deem it necessary to name or enumerate the number of such roads that constitute the various existing systems.

Prior to the enactment of the Transportation Act in 1920, public policy, speaking generally, was opposed to the consolidation or merging of railroads; but notwithstanding opposition, the creation of systems out of the 6,000 weak or so-called short lines proceeded and resulted in making some roads very strong and, through their thus enhanced power, deprived others of an equal opportunity and thereby forced or accentuated their weakness. The problem thus created became so serious that Congress reversed the long-standing governmental policy against mergers, and authorized the creation of a limited number of well balanced consolidated systems, into which it intended that all roads should be merged. In that way it was intended that the strong should absorb the weak, and thus not only effectively remove the problem of the weak, but materially increase the transportation facilities and service to the public.

Senator Albert B. Cummins, when discussing his proposed bill for consolidation of railway properties before the Senate Committee on Interstate Commerce on January 13, 1925, spoke as follows:

There was one great concern, when we formulated the Transportation Act, to take care of the short lines and to keep them running in the service of the people. That is the object of consolidation, and I think it is the one thing that will determine whether we are to have public or private ownership.

Again on January 21, 1926, with reference to the pending bill which he had prepared, Senator Cummins submitted a statement from which I quote the following:

Mr. Chairman and gentlemen of the committee, I think there is in the public mind some misapprehension with regard to the chief purposes of this bill, that is to say, S. 1870. It is a bill to facilitate further the consolidation of the railways of the United States into comparatively few systems. Many people seem to assume that the chief object to be accomplished by the consolidation proposed is to lessen the cost of maintenance and operation. While I believe there would be very substantial economies effected through proper consolidation, economies which have been estimated all the way from \$100,000,000 per year to \$300,000,000 per year, yet these economies, desirable of course as they are, do not furnish the impelling reasons for consolidation.

It is my opinion, Mr. Chairman, formed after years of intensive study, that our railroads can not as a whole be operated and maintained under private ownership upon rates as low as ought to prevail without consolidation.

Before calling attention to the provisions of the bill under consideration it is worth while to have clearly in our minds a general idea of the railway properties of the United States. In my description I will use round numbers for the sake of brevity.

We have 265,000 miles of single main-track railway. We have 149,000 miles of second, third, fourth, side, passing, terminal and switching tracks, or an aggregate of 414,000 miles of all tracks. . . .

Over these tracks and through these facilities there moves every year a little more than one-half of the rail traffic of the whole world. And in extent our system comprises more than one-third, nearly one-half, of all the railway transportation facilities of the world.

These railway transportation facilities are owned and operated by more than 900 separate, independent railway corporations.

More than 80 per cent of the traffic which moves in the United States is what we term competitive traffic. And the significance of this fact lies in this, that the rates employed by the two or more railroads accessible to the shipper from the point of origin to the point of destination must be the same, no matter what it costs the railroad to move it.

I will not pause now to submit the proof of the statement I am about to make. It is contained, Mr. Chairman, partially in the tables to which I have referred a moment ago, supplemented by the tables that I will introduce, bringing the statistics of this subject down to date. But it can easily be demonstrated by evidence that will not be disputed by anybody, that taking an average of three years past—and with a single exception these have been the best years the railroads have ever known from the point of volume of traffic—companies owning more than 60,000 miles of main-track railway have earned from less than nothing to less than 3 per cent upon the lowest estimate of the value of the property that could be attached to it under any rule of valuation.

I venture to say that a railroad which can not earn 4 per cent upon a proper valuation will not permanently survive. It is unthinkable, of course, that any such proportion of our transportation facilities shall be abandoned. The people who have invested their money in these railroads could lose it, if need be, without greatly destroying their comfort, but the people who are served by these roads must continue to be served or we would be met with a calamity overwhelming in its proportions. If competitive rates were increased so that these roads could survive the aggregate freight and passenger bill of the people of the United States would be intolerably advanced.

The object of consolidation, therefore, is to keep these roads running without giving to the more fortunate railway properties excessive incomes. And I desire to remark here that I am not primarily interested in the capital which has been invested in these unprosperous railroads. I would not willingly do any injustice to that capital, but no matter what happens to the capital, the railroads must be kept in operation, and not only in operation, but in efficient operation.

It is well known, I think, that in order to keep the railroads of the United States in fairly efficient condition for operation there must be expended each year, not for maintenance and operation, but on capital account for additions, betterments, and extensions somewhere from \$750,000,000 to \$1,000,000,000. There is but one way that a railroad has to secure this additional capital—I might say two ways. It must either borrow it upon its obligations or it must find some one who is willing to take its capital stock for an advancement of capital.

Nothing could be more fatal to the industries of the United States than a failure on the part of our railroads to keep pace with the growth of industry. Possibly you have not looked at it from exactly that standpoint, but I want you to look at it from this point of view. The facilities or capacity of our railroads for transportation absolutely measure and limit our capacity for production. Unless the various products of industry can be moved with reasonable promptitude from the places of production to the places of use or consumption it goes without saying that these products will not be long continued. Our transportation system, therefore, must be commensurate and adequate for the growing needs of a great people, the greatest people on the face of the earth from that point of view.

In my judgment there is but one alternative for consolidation. Obviously it is Government ownership and Government operation. It is simply unthinkable that these 65,000 or 70,000 miles of railway shall discontinue the service which they are now rendering to people who are depending upon that service, and if we reach that unfortunate stage in our railway regulation and railway development there will be but one thing to do, and that, obviously, is the acquisition by the Government of these railways and their continued operation at whatever cost may follow.

One railroad company has no inherent or fundamental right to acquire the control of another like company. That right, when it exists, is derived from legislation. The existing federal right is conferred in the Transportation Act, and is limited in several respects. Notwithstanding the fact that Congress authorized the consolidation of all the roads into a limited number of well balanced competitive systems, for the special purpose of having the weak roads included, thus eliminating that most difficult problem, most of the applications to the Interstate Commerce Commission for authority to merge have ignored that all-important object, and two of the most important applicants now before the Commission, the New York Central and the Great Northern Pacific, are fighting to obtain authority to merge the strong roads they desire, and at the same time are fighting just as strongly to defeat the very object that Congress had in view when it authorized consolidations.

Two very important applications asking authority to create systems in accord with the objects Congress had in view have recently been filed with the Interstate Commerce Commission. I refer to those filed by the Chesapeake and Ohio and the Baltimore and Ohio. The Chesapeake and Ohio officials, recognizing the obligation imposed by the law to include the short and weak roads, have made an agreement with the American Short Line Railroad Association to acquire and include in their proposed system every so-called short line that connects only with any one of the stronger roads which they desire to include. In addition, they have agreed to acquire each and every short or weak road that connects with any part of their proposed system, and also connects with one or more other systems, if and when the Interstate Commerce Commission shall allocate any such road to them. The agreement provides that in the event of failure to agree with the owner as to the price to be paid for any of the roads to be thus acquired, the owner may, at his option, have the sale value determined by the Interstate Commerce Commission, or by arbitration under the laws of the respective state, or by agreement which will include such provisions of the federal arbitration acts as may be appropriate and proper. The Baltimore and Ohio has, since filing its application, made a like agreement with my

Association, with respect to acquiring and including that class of roads, and will at an agreed time amend its application accordingly. These two roads have now recognized that Congress intended, when authorizing consolidation, completely to remove the weak road problem, and are the first to fully and willingly comply with the law by arranging to include all of that class or kind of roads. They have set an example for all future applicants, and we hope to see the commission establish precedents in these two cases that will govern in all future cases.

The interest of the public in the traffic and transportation services of the "weak" roads is great, and as Senator Cummins said in the statement quoted from him, "it is unthinkable that these 65,000 to 70,000 miles of railway shall discontinue the service which they are now rendering to the people who are dependent upon that service." There are several million people living and dependent upon our weak roads, but that is not all. A careful examination of traffic statistics shows that these weak roads originate from 20 to 23 per cent of all traffic handled by our rail carriers.

This all-important fact does not appear on the face of the returns, but it is true nevertheless. The ton-mile is the basis on which such statistics are usually set up, and a simple illustration will serve to show how the ton-miles are piled up on the main lines on traffic which they do not originate. Take a twenty-mile road in Oregon or Washington that originates a car of lumber carrying forty tons, destined to a point on the Atlantic Coast. It will be credited with 800 ton-miles, and the roads that handle said car to destination will be credited with 120,000 ton-miles, and the revenue is very often divided on practically the same basis.

This illustration clearly indicates that the small originating road receives but little credit and little revenue for its services, first in contributing traffic which the main lines must have to make them strong, and second in producing material needed by business enterprises on the Atlantic Coast and in all other sections of the country. I could enumerate thousands of instances to show that the public at large is vitally interested in the productions of the short or weak roads. I will for brevity's sake mention only one—the Death Valley Railroad in Cali-

foria, a road 20.6 miles long, originates and handles all or practically all of the borax produced in this country. Hence every citizen who uses borax or articles of which it is in any way a part is interested in the Death Valley Railroad, although few have ever heard of it.

From the beginning the short and weak roads have, generally speaking, been pioneers and have opened up vast sections of undeveloped country. They have supplied material for all kinds of plants and enterprises, and they continue to render that very valuable service for the good of all the people. Many of them have rendered such services, from time to time, at a loss, and some of them at a continuous loss; as a result they have continued to fail financially, and it is becoming more and more apparent that the public, if it is to continue to receive their services, must see to it that prompt, proper and adequate provision is made for their preservation through the consolidation of all into a few well balanced and strong systems.

If the public in its own interest demands it, the Interstate Commerce Commission will without doubt execute the law as intended by Congress, and decline to permit any merger, unification or consolidation unless and until the weak roads are satisfactorily included. Thus the great problem of the strong and the weak railroads will be solved. We shall then have a few well balanced systems that can pay their labor adequate compensation and render most efficient services at the lowest possible cost consistent with a fair return to their owners.

CONSOLIDATION AND EQUALIZATION¹

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IN the brief time allotted to me for commencing the general discussion, I must necessarily confine myself to one of the principal advantages claimed for the consolidation policy: that is, the advantage of the equalization of the financial status of the carriers rendering transportation service, by the combination of the strength of the strong lines with the weakness of the weak to produce a small number of systems with substantially equal capacity to earn a fair rate of return.

I shall endeavor to discuss certain aspects of this equalizing process. At the outset, I wish to sound a note of warning against expecting something for nothing. If the equalizing purpose is accomplished, each consolidated system will earn approximately the average rate of return which is being earned by the carriers in its rate group as a whole, but under existing conditions this is less than a fair return. The patrons of the weaker lines, therefore, cannot reasonably expect a consolidated system to give them reductions of certain rates or more expensive service unless the resulting drain from the net railway operating income is offset by rate increases affecting the stronger parts of the system or by operating economies.

I do not need to tell a group of transportation experts that the camel facing the needle's eye is carefree as compared with the traffic department seeking to compensate for rate reductions by increasing other rates. The prospect of such compensation, therefore, is far from bright in the immediate future. Hence, reduced rates or more expensive service for the weaker lines must be largely offset through operating economies. But we must not expect too much from the economies which result from large-scale production as such. Professor Splawn, in a book on *The Consolidation of Railroads*, has expressed a fear

¹ The following statement was made by Mr. Reynolds as leader of the discussion at the close of the Second Session, at which Messrs. Esch, Parker, Doak and Robinson had delivered the addresses printed in the preceding pages of this volume.

that the economies resulting from this source will be more than counterbalanced by the increased expenses traceable to the larger scale of operation, and he quotes Sir W. M. Ackworth as saying that the large systems of the United States have already grown to the point where it is probable that they have obtained all the economies which are due to large-scale production. But if the margin of present earning capacity is not sufficient to provide for benefits for the weaker lines, and if it is impracticable to receive much benefit by increasing rates on the stronger parts of the system or by operating economies, wherein can we find advantage in this equalizing process? In what ways can we reasonably expect to use the strength of the strong roads for the benefit of the weak without unreasonable sacrifice of the interests of the users and owners of the strong lines?

In the first place, we can use the superior credit of the consolidated system to finance capital expenditures for improvements, effecting economies in operation which will more than pay for the use of the capital so expended. Such use of credit will not only benefit the weak lines but will also strengthen the consolidated system as a whole to the extent that the net savings from improvements will increase the net railway operating income. You may ask why any line, weak or strong, cannot find capital for self-sustaining improvements. The answer is to be found in the fact that the financial structure does not always permit the subordination of prior liens on earnings. The prospective investors of new capital, therefore, may be unwilling to incur the risk of having the fruits of their investment diverted to the satisfaction of prior obligations.

Secondly, the weak lines can reasonably expect a larger proportion of the savings to be effected in the future from improvement in the technique of transportation than they can possibly receive if they continue to operate independently. Notwithstanding the immense strides which have been made in the past decade in reducing the cost of transportation, I have confidence in the skill and initiative of management to continue this process in the future. When the process reaches the point at which more than a fair return is being earned upon the aggregate value of the consolidated system, I fail to see how anyone can fairly object to the use of the excess to equalize standards of service throughout the system and to reduce such

rates as may be out of line with the general rate structure. We all know the nibbling process that accompanies economies of operating cost, the gradual nibbling away of the resultant savings by reducing first one group of rates and then another, until management feels it has saved and saved and yet has saved nothing. Consolidation would permit this nibbling to be done in a more selective way than is now possible, giving to the traffic of the weaker lines the lion's share of the nibblings which would bankrupt those lines if attempted under present conditions of ownership. Thus, the weaker lines could receive the benefit not only of the savings arising from future improvement in transportation technique on their own parts of the system, but also of those savings arising elsewhere to the extent that is necessary to place them on an equality with the entire system with respect to standards of rates and service.

It must be conceded, of course, that such use of the savings on the strong lines for the benefit of the weak would *pro tanto* prevent reduced rates and improved service on the stronger lines, but to the extent that this is necessary to remove inequalities it is just and reasonable, and from the sordidly practical aspect it is much less difficult of achievement than equivalent equalization accomplished through increasing particular rates.

Another advantage to the weak lines from equalization of strength is the application of the insurance principle. By that I mean insurance against the risk of insolvency with the attendant evils, evils which spread far beyond the users and the owners of the insolvent line and cast their shadow over the industry as a whole. A weak line is obviously subject to the risk of insolvency, particularly if its earning capacity is dependent upon the prosperity of one or two industries. It is capable of mathematical demonstration that when the risk of one weak line's becoming insolvent (which is very considerable) is combined with the equally great risks of other lines, dependent upon other industries, the risk of insolvency of the group as a whole is reduced almost to the vanishing point. The contribution of any one industry to the earnings of the whole group becomes relatively insignificant. Furthermore, depression in one industry is likely to be offset by expansion in others. It is therefore hardly too much to say that with the combination of the various systems into a few with well balanced traffic, the risk of insolvency will become almost negligible.

Another advantage to the railroads as a whole from the equalizing process is relief from the operation of the recapture provisions of the Transportation Act of 1920. This may seem like an academic question because so small a part of the earnings has actually been recaptured, but there are now distinct signs of activity to enforce these recapture provisions, and a decision favorable to the government in the O'Fallon case ¹ may lead to considerable recaptures from some of the more prosperous carriers. It is not generally realized that if the commission should succeed in establishing rates which will yield approximately the fair return for each rate group as a whole, the amount available for distribution to the investors will still fall short of a fair return in the aggregate for the group. This is because a part of the net earnings of the stronger systems, included in the fair return for the group as a whole, is subject to recapture. The recapture provisions fail to provide any machinery for applying earnings so taken from the stronger lines to augment the concededly inadequate income of the weaker lines. A policy of consolidation which really succeeded in equalizing the financial strength of the carriers would remove this defect. There would no longer be any considerable amount of recapturable earnings; earnings which, under existing conditions, are now recapturable would then be available to offset the deficiencies of the weak lines. Thus, if a consolidated system succeeded in collecting revenues sufficient to pay a fair return upon the value of its property, this fair return would not be subject to discount by recapture before it was available for distribution to the investors for whose benefit it is presumably collected.

To summarize, I believe that the equalization of strength resulting from consolidation will provide credit to make self-sustaining improvements which would otherwise be impossible, will permit the use of the savings from future improvements in transportation technique to equalize standards of rates and service, will greatly reduce the risk of railroad insolvency, and will prevent the dilution of a fair return for a rate group as a whole by recapture of part of that fair return.

¹ Since this address was delivered, the O'Fallon case has been decided in favor of the railroads.—ED.

PART III
PENDING CONSOLIDATION LEGISLATION

COMPETITION AND RAILROAD CONSOLIDATION¹

EDWIN R. A. SELIGMAN

McVickar Professor of Political Economy, Columbia University

THE whole topic involved in consolidation or what is now called railroad unification is interesting because it shows that every country in turn goes through certain stages in its development both as regards fashion and as regards public opinion. If you take the history of the United States from the beginning it will be found that for a long time we were wedded to the idea that in railways, as in everything else, salvation was attainable only by a process of out-and-out competition. Competition has given us many good things in this country, but it brought with it also certain disadvantages and abuses. As a result, after three-quarters of a century, this country, reversing its policy in part, went over to the idea that certain kinds of competition, at least, must be abandoned in favor of the doctrine of regulated monopoly.

In England and France, it is interesting to observe, they have gone a step farther than we have. We are not ready for that quite yet; the very immensity of our empire and the complication of our problems makes the situation much more difficult. In France, as you know, the unification came at the beginning. Instead of accepting competition of any kind, they adopted the principle of complete monopoly, dividing the whole country into six districts, with the roads radiating from Paris. England, on the other hand, started out as we did, with competition, but went over many years ago to pools and consolidations. Finally, after the War, the British proceeded to the districting of the field, a unification which they were able to achieve only through compulsion: that is, they were prepared to lay down the heavy hand of the law upon the railways, which before the expiration of the time limit were quite willing to accept the new dispensation.

¹ Introductory remarks of presiding officer at the Third Session of the Semi-annual Meeting of the Academy of Political Science, April 24, 1929.

We have gone halfway. We no longer believe in certain kinds of competition, such as the cutthroat competition in rates which led to the railway wars, and the many others that happened half a century ago. In the projects for consolidation that are still before the country and for which provision is made in the present law, we have retained the idea of a certain kind of competition, competition in facilities rather than competition in rates. In Great Britain it will be remembered that the commission of 1872 showed the futility in that country at least of competition in facilities. In this country we have not gone so far. Accordingly, in each of our chief districts it is proposed to retain at least two—perhaps more—lines, as the New York Central and the Pennsylvania. The most interesting thing in the present discussion is the consideration of the reason why we are still in that period of interval. We have abandoned our belief in certain kinds of competition. We have not yet reached—if we ever are to reach—the period of the European belief in the absence of all competition.

In the practical problem that confronts us, we are fortunate in having the present American point of view presented on both sides, the political and the technical, by leading representatives of the public as well as of the railways.

THE CHANGING ATTITUDE OF PUBLIC POLICY TOWARD RAILROAD CONSOLIDATION

WINTHROP M. DANIELS

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Interstate Commerce Commission

RAILROAD consolidation after all is only a chapter in the larger history of industrial integration. Much the same type of opposition that earlier developed against the growth of industrial combination has, of course, been encountered by railroad carriers.

In both instances the opposition has centered in the apprehension that the public interest is jeopardized by any departure from relentless, undeviating and all-pervasive competition between the multitude of relatively small industrial units. The proverbial philosophy ran to the effect that in the multitude of competitors there is safety; or, to use another metaphor, that competition was a tender plant, best cultivated if set out in a large number of containers.

It need not therefore surprise us that a quarter of a century ago the attitude of public opinion toward railroad consolidation was one of hostility, and the attitude of law was one of prohibition. Linear, or end-to-end, amalgamation of railway lines marked the limit of legally permissible consolidation, and even this harmless and necessary act encountered at first misgiving and resistance. Professor F. J. Stimson, professor of comparative legislation in Harvard University, published a volume in 1908 on *The Law of Federal and State Constitutions*, in which he gave a cross section of what was then typical of most state constitutions in respect of railroad consolidations and combinations. "Most state constitutions provide", he tells us, "that no railroad may consolidate with a competing or parallel line, or acquire it by purchase, lease or otherwise, or own or control its stock, or pool its earnings with it, or operate it; nor may the officers of one act as the officers of the other road." In four states the question of what were parallel and competing roads was specifically made a question for the jury, and one

exceptionally provident state had already provided against the evasion of these provisions through holding companies.

The original act to regulate commerce in 1887 contained an ironclad prohibition of pooling, and its complete silence upon the whole matter of consolidation is probably to be attributed to the fact that the then accepted idea was that this matter was one for the states which had created the corporations.

When Mr. Harriman created his meteoric and premature consolidation of the Union and Southern Pacific, the Interstate Commerce Commission investigated the entire situation, and in 1907 reported that, "If the policy of purchasing and controlling stocks in competing lines is permitted to continue, it must mean suppression of competition"; and that, "It is contrary to public policy, as well as unlawful, for railways to acquire control of parallel and competing lines". The commission added: "This policy is expressed in the federal laws and in the constitutions and laws of nearly every state in the Union Competition between railways as well as between other industries is the established policy of the nation."

That finding by the commission in 1907 had ample ground in the prior decisions of the Supreme Court. Some ten years previously, in the *Trans-Missouri* and *Joint Traffic Association* cases, the Supreme Court had held that the Sherman Anti-Trust Law applied to railroads and made illegal the agreements or associations to establish or maintain rates. In 1904, the Supreme Court had declared the *Northern Securities Company* illegal in its restraint of interstate commerce and thus the holding company was brought within the inhibitions of the Anti-Trust Act.

Finally, in 1914, the Clayton Act was passed, marking the termination of this type of legislation. This act in express terms forbade any interstate carrier to acquire directly or indirectly any stock in another similar carrier where the acquisition would substantially lessen their mutual competition; and another section restrained holding companies from effecting a similar result. In short, as regards railroads and their combination we began where, in sumptuary regulation, up to date, we have ended—with prohibition.

The next phase in the attitude of public policy and law toward railroad consolidation was the phase that I think we may fairly designate as a phase of partial or relaxed regulation. In the field of local public utilities it had been recognized as early as 1907 in the state of New York and in the state of Wisconsin and in other forward-looking jurisdictions that the old idea of exacting rigorous competition from local utilities was decidedly not in the public interest, that it involved an unconscionable degree of competitive waste and that regulated monopoly was a very appropriate substitute for this previous policy, whose results had often been so disappointing where they had not been disastrous. I remember distinctly, back in 1913, when the New Jersey Board of Public Commissioners declined to allow a gas company to enter upon a region that was already piped and supplied with gas, it evoked very considerable adverse public comment and criticism as though it were an affront to the God of Competition.

One distinguishing mark of this more rational view of the whole matter of railroad consolidation or of the attitude of the state toward railroad corporations is found in the early institution of the certificate of public convenience and necessity, which was a recognition on the part of the state governments of the propriety of the new policy of regulated monopoly. Even in the field of interstate commerce itself there had been, long before the passage of the Transportation Act, some relaxation of the earlier, more rigorous attitude with reference to railroads and their obligation unflaggingly to compete.

In 1910, you may recall, when the railroads jointly proposed an increase in their rate levels, the unwieldy, antiquated artillery of the Sherman Anti-Trust Law was again unlimbered and an injunction was applied for, whereupon the carriers withdrew their proposals until then pending legislation before Congress was completed. As a result, the Mann-Elkins Act was passed, which vested the commission with the power of suspending rates that might be filed to supersede rates already in force. This was the price which the railroads really paid to escape the charge that their conjoint and associated action with reference to rate matters was really a conspiracy to restrain trade and commerce and a violation of the Sherman Anti-Trust Act. It could hardly be a conspiracy to associate

themselves together to accomplish a result which they were powerless altogether to accomplish unless that result first received the official sanction of an administrative tribunal. So, even before the passage of the Transportation Act of 1920, there was some appreciable relaxation of the stricter form of the doctrine of the duty of railroads unflinchingly to compete.

We are at the present time, and have been since 1920, in the third phase, which is one of virtual abandonment of this doctrine. The act of 1920 relaxed the absolute prohibition upon pooling. It admitted the possibility of consolidation under certain provisions carried in the act. I think it was wise that in providing for consolidation the act of 1920 retained the idea that, so far as possible, competition should be preserved.

Of all the points made this morning, one of the most striking was made very sharply by Mr. Blair of the Southern Pacific: that not infrequently the result of consolidation is actually to create competition where it did not exist before, and to sharpen competition, to intensify it rather than to destroy it or to eliminate it. I believe, therefore, that the retention of substantial competition in service, at least at those common key points served by the various competitive systems, was a wise provision of the act of 1920.

There are some things in the act of 1920 about which I wish to say a word or two in the way of adverse criticism. I think it is true that the passage of the act of 1920 with its permission of railroads to consolidate under certain circumstances was based in part upon the utopian idea that drastic reduction of operating expenses could readily be translated into substantial reductions in the general level of rates. There never was any solid, quantitative reasoning upon which the expectation was based. A wholly superficial assimilation of railroad transportation to industries where mass production and minutely specialized fabrication have yielded astounding reductions in unit costs seems to have prompted this ill-starred illusion. Moreover, experience since the war seems to have established two facts: first, that the notable economies in railroad transportation have been realized in the main through methods that are not remotely connected with company consolidation; and second, that the gains, actual or claimed, for consolidation in the immediate curtailment of aggregate ex-

penses are so modest in measure as to negative the idea that they can be the speedy harbingers of rate reductions. This is not to say that these economies should not be promoted and encouraged through consolidation. But we should cease to entertain unfounded anticipations on this score.

I find I shall have to differ with some of the gentlemen who have addressed you with reference to the weaker lines of railroads, whose reinvigoration was contemplated by the Transportation Act. The anticipation that the financially weak roads would be absorbed by the more prosperous systems and that thus a second advantage would be afforded by consolidation seems to me to be devoid of clear vision. If the weaker lines and the communities dependent upon them have a claim for sustentation and support (and I am not impugning or denying or even arguing the point), the claim should have been addressed to the public or the government, state or federal, which by acquiescence or otherwise encouraged their promotion and operation, and not to stronger rivals which did neither. One might as equitably levy a special tax on colleges and schools for the abolition of illiteracy as to cast upon the successful carriers a burden for which they are least of all responsible. It amounts to charging the successful carriers with being morally responsible for the existence of the plight in which the weaker carriers are found. It is true that the stronger carriers seem to be inclined to accept the burden. At least some of the proposals for consolidation intimate that they will take on such weaker carriers as the commission indicates as appropriate, but in my opinion it is an undertaking to which they are not necessarily committed in sound morality.

Another roseate expectation which has been entertained about consolidation of railroads into a limited number of systems is that it will very greatly simplify the task of regulation. Without pretending to elaborate or expert knowledge, I know enough about regulation to know that it is easy to exaggerate the lessening of the difficulty of regulation by diminishing the number of systems. It is not generally recognized how thoroughly our rate structures are at the present time, and have been for the last two or three years, in process of almost complete transformation. The entire rate structure of the Southeast has been changed in the last three years. The so-

called basing-point rate you read about in all the histories of transportation is as dead as Julius Caesar. The Texas common-point group that used to be cited as a great example of group rates has disappeared since the readjustment of rates in the Southwest, and the complete transformation of the rate system in official classification territories has advanced so far that you have already the report of the examiner in the case, with hearings scheduled for the immediate future.

I recently took occasion at Washington to inquire whether the matter of rate transformation and regulation would be essentially facilitated by the consolidation of carriers into a small number of systems. It apparently had not occurred to some of those who were doing the actual work of rate creation that there is any particular difficulty involved in the fact that there may be fifty systems in the Southeast, or forty in the Southwest. With the exception of giving a slight surcharge to the weaker lines over and above the distance scale rates that have been applied, they could see no way in which consolidation affects the matter at all.

The crowning error, however, in my judgment, in the Transportation Act was its erecting a formidable number of impossible hurdles to be taken before actual legal consolidation could be effected, while at the same time affording every facility to substantial unification through lease, stock control or other means short of actual consolidation. I forbear to mention the comprehensive plan which the commission was required to promulgate as the pattern according to which voluntary consolidation might be effected.

I confess to a little surprise at Mr. Willard's feeling of resentment at the dilatory character of the commission's action. I think I personally escape his censure because I have been off long enough to secure a verdict of acquittal. But what is the duty of a public administrator when he has made a careful investigation and finds that he is confronted with a practically impossible or a totally useless task?

I remember discussing with the counsel of the Delaware and Hudson what the commission ought to do in valuation proceedings when the law tells the commission to report the original cost of construction new, and the cost of reproduction less depreciation. The commission reports in practically every

case that the original cost cannot be discovered. My friend, the counsel for the Delaware and Hudson, said, "It is the legal duty of the commission to report the original cost of construction." "But," said I to him, "what are you going to do? Suppose the law required you to find the original cost of construction of the Pyramids and also the cost of reproduction. What ought the commission to do with reference to reporting the original cost of construction of the Pyramids?" He replied, "You ought to find as near as you can what the original cost was and then report it."

What advantage would that be to any living soul? When an administrative body after careful consideration of the legislative mandate and with full deference to the legislature, with willingness to carry out their mandate if insisted upon, reports back, "We find that it is a futile, useless, or impossible task", may they not be fairly warranted in giving the legislature the opportunity to reflect upon their deliberate judgment instead of going ahead to waste their own time and the government's money in reporting something which they feel would be a mere waste of good paper?

So far as the Transportation Act is concerned, it required the prior final determination of the values of the properties to be consolidated as determining the amount of securities the new corporation might lawfully issue. This, in my opinion, looks down a vista of seemingly endless litigation. But what, it seemed to me, capped the climax of absurdity in the act, was the simultaneous provision of a quick and expeditious method of unification, and one carrying the same immunity from the anti-trust laws and prohibitions which was promised as a prize for the more arduous and interminably postponed course of seeking the goal of literal legal consolidation.

Unification was devised to serve as the temporary entrance hall to the temple of consolidation, and the same dispensations were to be bestowed in the entrance hall as in the temple itself. The result has been that the entrance hall has been crowded with supplicants, and the foundations of the temple are still literally up in the air!

It is very much as though the legislature, in drafting a code to govern family relations, had, through some regrettable mis-

take, put a legal premium upon "companionate marriage", rather than upon the well-known market brand.

Finally, there is reason to think that at last we are in sight, by reason of pending legislation, of what we may call the state of definitive realization of consolidation. Experience since 1920 has made it reasonably clear that projected consolidation proposals must come from the companies rather than from above. It is enough, if their plans conflict, to have an official arbiter decide where the public interest lies. The manifold details of balanced traffic, with raw materials for sustained volume, and manufactures for their coveted contributions to high-rated business; the connection with gateways which serve as funnels for regional products; the betterment of routes by substitute lines with lower gradients; and the requisite balance in size which avoids a disproportionate overhead, are all factors more accurately gauged by railway experts than by official super-Solomons.

All these considerations but point the way to the lines on which beneficial consolidation legislation can be founded. Such legislation must court company initiative in framing the project; it must guard the public interest by subjecting it to scrutiny by a tribunal which seeks to determine that interest; it must perpetuate the plan of a definitive partition of interlacing traffic lanes with service competition at key points, and finally, it must be reasonably expeditious.

We are industrially and commercially mature enough to lay down something like a railroad Monroe Doctrine, that broad avenues of commerce definitively assigned to system operation are no longer to be regarded as subject to colonization or invasion by any foreign disruptive agency.

THE PROPOSED RAILROAD CONSOLIDATION ACT OF 1929

HONORABLE SIMEON D. FESS
United States Senator from Ohio

THE commercial progress of the nation has been phenomenal. One of the chief agencies of that growth is transportation, including steam, water, highway and aerial transportation. Steam transportation has advanced to the point where we now have the most efficient service in the world. Water transportation will receive more and more attention. Highway traffic is increasing by leaps and bounds, and air navigation is the newest, and will take a wide range in the near future. I will speak here of steam transportation, with reference to one outstanding problem.

The problem of railroad unification is to reduce many systems to a few. Steam transportation to-day is owned by nearly 2,000 companies and is operated by nearly 1,000 separate organizations. The problem is to reduce these to, say, twenty systems. That would consolidate the more than 250,000 miles of road into systems of around 10,000 miles each, on an average.

The unification proposal is based upon the principle of concentration and control. Concentration is the order of the day in modern industry. It is in the interest of increased efficiency and sound economy. Control is necessary in the public interest, which is the real test of all legislation.

This principle was recognized in the act of 1920, but little progress has been made since that date. In accordance with the mandate of the law requiring a complete plan of unification, such a plan was submitted by Professor Ripley of Harvard, but was not accepted by the Interstate Commerce Commission. Later the commission submitted tentatively its own plan, but finally recommended to Congress the repeal of this mandate as an impracticable requirement. However, the commission is again working upon such a plan, but as yet has not reached a final decision.

Recommendation is also made in respect of: (1) the prohibition of any unification without the approval of the Interstate Commerce Commission; (2) the power of the commission to reject any unification unless some specific line or lines are included; and (3) some other minor changes.

Amendments to the present law to facilitate unification have been urged by the commission, and also by Presidents Harding, Coolidge and Hoover.

I introduced a bill in the last Congress, and the Committee on Interstate Commerce reported it, to facilitate unification. It is supported by the American Railway Association, representing the Class A roads; by the Short Line Association, representing Class B and C roads; by the Industrial Traffic League, representing the shipping public; and by economists and students of transportation. In the hearing on the bill no one appeared in opposition to the proposal.

The touchstone of this proposal is the public interest. Legislation to be justified must meet this test. While it should respect the rights of the owner in profitable investment, and the rights of labor in a proper wage standard, it must also respect the rights of the public in adequate service, which, after all, is the final test of all legislation.

In the public interest, unification must retain necessary competition. It must avoid any undue lessening of existing competition. Competition in service is the surest guaranty of adequate public interest, while absence of competition is the certain abandonment of adequate service. Unification on these lines will insure economy in operation. The larger system can make better use of its equipment. It will permit more direct routing of cars, and less back-hauling of freight. It will make available direct lines for fast freight. It will reduce the cost of switching. It will insure standardization of methods and equipment, maximum utilization of shops and equipment, and concentration of purchasing agencies.

Unification will doubtless insure better service by strengthening credit facilities, which will permit additions and betterments in equipment and roadbeds. A great system will be in a position to make direct and fast shipments, to supply the demand for cars of special type, and to give regular and more adequate and satisfactory service by each system's connecting

with another system. Such a plan will permit the operation of solid trains to and from large centers with a maximum use of terminals. It will insure uniform service throughout the year. It will also lessen and simplify the problems of regulation. It is obvious that the Interstate Commerce Commission, now dealing with nearly 2,000 companies, with their varied complaints, would be greatly relieved if these could be reduced to a score or more of systems.

Whatever else may be urged as argument for the unification of roads, the primary or conclusive argument is the strengthening of the weak lines, first to insure more adequate transportation, and secondly to avoid government ownership. I fully agree with the late Senator Cummins that we have the alternative of preserving the weak lines through unification, or the adoption of government ownership of transportation.

There are many railroad companies, totaling thousands of miles of road, which have ceased to be profitable, either through lack of equipment or through loss of traffic by the exhaustion of sources, that is to say, the working out of mines, the cutting off of the forest, etc.; or the failure may be due to bad management. Whatever be the cause of the failure of these roads, they supply a service for the communities built up by them. To abandon these roads because of loss in operation would be to abandon the people of the community. Independent operation at a loss cannot continue indefinitely. If the alternative is presented either to abandon the roads or to operate them by the government, the latter will be the controlling alternative. These roads, under such a situation, are sufficient in number and influence to dominate sentiment for government ownership. If it is once entered upon to cover these weak roads, the next step will be the inclusion of the strong roads. The average American citizen does not realize the strength of government ownership sentiment in the country. It is heard in the halls of Congress as well as in the forums of public opinion. It looks to public utilities, such as communication agencies—telegraph, telephone and radio. The advocates of government ownership scan power development, especially hydroelectric power, as within their field, and are by no means excluding transportation as a public function of the government. There can be little doubt of what will be done in case no way is found

to preserve those roads which cannot continue as independent lines. The only alternative in sight for government ownership is unification, by which a line, weak as an independent unit, may become a source of profit as a feeder of a general system. A great system depends upon its feeders, each of which may contribute profit to the system, while it could not exist alone. One system made up of a hundred branches, taken together, may be profitable, whereas the same lines operating as a hundred separate systems would be unprofitable.

Conversely, we may have a region served by a hundred separate and unprofitable roads, which if consolidated into one system with a unified management and equipment might quite profitably insure a better public service. It is on that basis that the principle of unification has been and is now being urged. It has at once enlisted and stimulated the support of all classes who look on government ownership as unwise, and will provoke the opposition of those who view the policy of government ownership as the better plan of operation.

The urgent need for unification to include all lines, on the one hand, and the hesitancy of systems to include roads obviously weak, on the other, have created sentiment for compulsory unification. The pending bill is not compulsory, but voluntary. However, it does give authority to the Interstate Commerce Commission to deny the unification unless the proposed system includes such roads as the commission deems necessary. The bill provides four methods of unification: (1) where it is accomplished by one system's taking over the physical properties of one or more other systems; (2) where a corporate merger is created by one or more systems, merging into the corporate control of an existing system; (3) where a consolidation is effected by an entirely new corporation created by absorbing other systems which lose their existence; and (4) where one system purchases the securities of other roads.

The hope of the proponents of this relief legislation is to insure an adequate transportation system operated by private enterprise under proper regulation in the interest of the public.

It will be a definite announcement of a transportation policy which will afford management freedom to proceed with improvements demanded by a growing community, which will in time unlock resources and insure still greater prosperity.

THE STATUS OF RAILROAD CONSOLIDATION

DANIEL WILLARD

President, The Baltimore and Ohio Railroad Company

THE Transportation Act now in effect became the law of the land on March 1, 1920. In this act there was included a provision whereunder, for the first time, the Congress of the United States announced that it should be a part of the future transportation policy of this country to combine the railroads into a limited number of groups which should be as nearly equal in size and circumstance as might be possible, so that those systems located in the same general rate territory would be able to operate their properties and maintain their credit upon the basis of rates fixed by the Interstate Commerce Commission for that region.

Before the passage of this act, laws passed by the Congress at different times, such as the Sherman Act and others, had frowned upon, if not definitely prohibited, action of that kind, which implied at least a certain amount of curtailment of competition. The passage of the consolidation provision in the Transportation Act of 1920 marks, therefore, a distinct change in the attitude of Congress, and presumably of the people whom Congress is supposed to represent.

The consolidation provision in the Transportation Act, as it stands to-day, was not urged or put forward by the railroads, as a whole, although it may be that some of the railway managers were in favor of such legislation. Senator Cummins of Iowa had as much to do with framing the act and procuring its passage as anyone, and I am certain that Senator Cummins would not have supported the act unless he felt quite certain that by doing so he was promoting the interests of the people at large, and properly so.

In my opinion, the policy concerning consolidation as set forth in the Transportation Act is economically sound and if it is carried out as Congress evidently expected and desired, I believe the result will be generally satisfactory.

The idea itself of railroad consolidation did not originate in the Transportation Act. On the contrary it had played a most important part in shaping the development of the American railroad system as it was at the time when the Transportation Act was passed. It was by virtue of consolidation that we had at that time and have today such large and efficient systems as the Pennsylvania and New York Central companies in the East, and the Southern, the Santa Fe, Burlington and Southern Pacific companies in the South and West.

Congress must have recognized that transportation systems such as those I have just mentioned were able, by the very fact of their size and ramifications, to serve their patrons better, more efficiently and more economically than would have been the case if their component parts, which had been put together in the process of development, had remained, instead, separate and independent companies. Undoubtedly it was with this in mind that the consolidation provision in the Transportation Act was written, with the expectation that ultimately a few well balanced systems might take the place of the much larger number of smaller and unequal lines.

Doubtless if the subject were being considered *de novo* by Congress today, a more easily workable provision could be drawn than the one which is now a part of the Transportation Act. Even so, in my opinion it is quite possible to accomplish under the existing act what Congress had in mind, and this is not to say that certain modifications of the act which have been suggested might not simplify the process and expedite progress toward the complete working out of the policy.

There is nothing in the act itself which enjoins the railroads to do any particular thing toward bringing about consolidation. Such instructions or directions as the act contains are all addressed to the Interstate Commerce Commission. The commission, in the terms of the act, was definitely instructed to proceed forthwith and prepare a tentative plan for the consolidation of all the railroads in the United States into a limited number of groups. The commission employed Professor Ripley to make a study of the matter, and I know of no man better qualified than he to perform a task of that character.

Professor Ripley's report, with slight modifications, was adopted by the commission and published as its tentative plan.

The commission then proceeded to hold hearings concerning the tentative plan in Washington and other cities extending over a period of nearly two years. The hearings were closed on December 4, 1923. At these hearings full opportunity was given for everybody to be heard, and presumably everybody was heard who was sufficiently interested in the matter to request a hearing. There developed much difference of opinion concerning the commission's tentative plan, as was to be expected.

The act also directs the Interstate Commerce Commission to prepare and publish a final plan after having terminated its hearings on the tentative plan, but this latter duty the commission has not yet performed, although more than five years have elapsed since the hearings were closed. The task of preparing a final plan for the consolidation of all the railroads into a limited number of groups is a very complex and difficult one, and, no doubt, Congress realized that fact. Nevertheless, it is most unfortunate that the final plan was not long ago published, as the law requires.

The Transportation Act is a public document and immediately after its passage became a matter of public knowledge. At the time when the law was passed there were upwards of 2,000,000 men and women in the employ of the railroads of the United States. Most of them, certainly the majority of them, expected to remain in the service of the particular company by which they were then employed during the working period of their lives, and they felt able in very considerable degree to visualize the wages or salary which they would continue to receive, the duties which they would probably perform, and the place where they would probably have their homes as long as they remained in the service.

With the passage of the consolidation provision of the act this situation was very greatly changed. It would, of course, be impossible to take several hundred separate and independent railroad companies and merge them into twenty or thirty systems without making many changes which would have more or less effect upon the duties and the home location of those in the employ of the particular companies which were likely to lose their identity, and the effect of this was, of course, to create a greater or less degree of uncertainty in the

minds of such men and women. The fact that such a change was impending was not without influence upon those who were contemplating entering the railway service. I feel that I am quite within the mark in saying that the future of three-fourths of all the officers and employees in the service of the railroads seemed to them less certain and, consequently, less attractive after the passage of the act than it did before.

We will agree, I am sure, that if the facts are as I have stated, the situation so developed was an unfortunate one. That condition has existed in varying degree during the ten years that have elapsed since the passage of the Transportation Act.

It is my thought that in the consummation of any plan of consolidation or unification involving the Baltimore and Ohio which the commission may approve, the Baltimore and Ohio should undertake to safeguard the interests of all its employees. More specifically this means that every man employed by the Baltimore and Ohio should, so far as it is possible and justifiable, be retained in the service of the company in the same work and at the same compensation, and that this same treatment should be extended to the employees of other companies which may be unified with the Baltimore and Ohio. In the event that because of such unification it should become necessary or economically desirable to combine any of the functions of the properties constituting the unified system, or through the modification of existing operations or practices to suspend or terminate certain classes of employment at certain points, the Baltimore and Ohio should undertake to the best of its ability to provide similar or equivalent employment for such employees at other points and to assist in their relocation. I may add that in the working out of this same problem by the railroads in England, the obligation of the carriers to their employees has been recognized and defined by Act of Parliament, and the matter has been dealt with along lines such as I have just indicated. To do less than this would be unjust to a large group of deserving men and women who are now looked upon as semi-public servants. The public interest, in my opinion, does not require, nor would the public itself desire to receive, benefits derived from the unjust treatment of those who now man and operate the railroads.

There is another phase of the situation growing out of the unsettled status of consolidation which has been equally harmful and is becoming increasingly more so. The Baltimore and Ohio Company will, of course, be affected in some manner by the working out of the consolidation policy, but because of the size and location of its property the Baltimore and Ohio, in all of the plans that have been suggested for the Eastern Region, has been made the basis of one of the groups proposed. But even so, that company has not escaped the influence of the uncertainty of the situation as a whole.

The Baltimore and Ohio management, for instance, was able in the past, before the passage of the Transportation Act, to decide with reasonable promptness matters pertaining to the future needs and development of its property. Its officers could plan intelligently for the care of the additional business which might be expected in the future, but as conditions have actually been since the enactment of the consolidation provision, it has been quite impossible to deal understandingly and definitely with many of the problems which constantly arise. I have in mind questions affecting location and development of shops, the purchase of additional motive power and equipment, the possibilities of a greater use of existing facilities and so on through the entire list.

It may be said that in spite of this the railroads, since the passage of the Transportation Act, have spent roundly \$600,000,000 a year for enlargements and betterments. But even so a much larger sum might well have been expended, and, in my opinion, should and would have been expended, but for the uncertainty of the situation which I have been discussing.

I think it is generally admitted that during the last four or five years the railroads of the United States as a whole have given a more dependable and efficient service than ever before, and it has been pointed out by economists, public officers and others that this has been the means of saving millions, even billions, of dollars to industry and the public generally. It is certainly to the best interest of the country as a whole that the service of the railroads should be maintained at the highest possible standard. It is quite certain that it will not be maintained at that standard if the period of existing uncertainty is too much prolonged.

I do not expect that there will immediately be realized, as the result of such consolidation as may be made, the large savings from operation which have been suggested by some, promised by others and, perhaps, expected by all. Consolidation of the kind indicated in the act will, undoubtedly, result in ultimate economy, I might say in substantial economy, but the chief and more immediate benefit to be derived from such a plan will be the improved service which will be possible and which, of course, will inure directly to the advantage of all those who use or benefit by rail transportation.

If the railroads in the United States were all combined in twenty or thirty groups or systems, each coterminous with the rate region in which it was located and each group so built up as to afford it reasonable equality of opportunity in originating traffic, as well as in its interchange and delivery, such an arrangement would very greatly simplify the problem of railroad regulation as it is today.

Under such an arrangement there would no longer be any real reason for keeping in the act the provision for recapture by the government of one-half the earnings of the railroads above six per cent upon the value of their property used for transportation purposes. I happen to know that Senator Cummins himself expected that when consolidation should have been brought about the recapture provision of the act would be repealed, there being, in his opinion, no longer any occasion for it in our system of regulation.

Because of the adverse effect which the uncertainty of the situation has had and is having upon the railroads, some of the managers in the different groups have endeavored to work out a voluntary agreement which it was hoped would meet with the approval of the commission. This duty was not imposed upon the railroads by any of the terms of the act. The railroad managers who have given much time to the finding of a solution have been prompted in their efforts by a desire to see an uneconomical and even wasteful situation brought to a satisfactory conclusion. The efforts which the railway managers have made in this connection have so far failed to accomplish any substantial result.

The commission was directed by Congress to do a definite thing, which, if done, I am sure would have been most help-

ful in the solution of this problem. The commission has not yet done the thing which it was directed to do and until it acts and by so acting indicates more clearly the kind of a program which it thinks should be followed and which it might be willing to approve, I doubt if any very considerable progress will be made. There is reason to believe, however, that the commission is taking renewed and deeper interest in this matter and I hope that within the next twelve months a substantial beginning, at least, toward a solution of the problem will be made.

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PROCEEDINGS
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Volume XIII]

JANUARY, 1930

[No. 4

BUSINESS, SPECULATION AND MONEY

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE ANNUAL
MEETING OF THE ACADEMY OF POLITICAL SCIENCE
NOVEMBER 22, 1929

EDITED BY
PARKER THOMAS MOON

THE ACADEMY OF POLITICAL SCIENCE
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1930

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PREFACE

THE Wall Street cataclysm of October and November, 1929, afforded a spectacular demonstration of the need for scientific exploration of the subject selected by the Academy of Political Science for discussion at its Annual Meeting (Forty-ninth Year), namely, the problem of "Business, Speculation and Money". Seldom has an event of such moment been so closely followed by a conference devoted to expert analysis of its causes and its meaning. The following pages, comprising the addresses delivered before the Annual Meeting, together with abstracts of the ensuing discussions, may be said to have a certain vitality and historic interest as a contemporary account of the dramatic stock market crash of 1929. For the present time, however, they possess even greater value in so far as they present the studied conclusions of outstanding economists and men of affairs on the general problem of financial stability. In offering this volume to its members and to the public, the Academy refrains from sponsoring one or another of the conflicting views expressed by the participants in the discussion. The purpose of this publication is to lay before the public a representative and balanced collection of expert studies in the hope that these may be provocative of further scientific inquiry leading, perhaps, to salutary action.

The program of the Annual Meeting was as follows :

PROGRAM

FIRST SESSION

Friday, November 22, 1929, 10 A. M.

North Ballroom, Hotel Astor

TOPIC : Speculation, Credit and Business

HON. OGDEN L. MILLS,¹ *Presiding*

1. *Progress in American Finance and Economics.* JACOB H. HOLLANDER.

¹ Unable to attend.

2. *Fluctuations in Brokers' Loans and Interest Rates.* BENJAMIN H. BECKHART.
 3. *New Measures of the Relations of Credit and Trade.* CARL SNYDER.
 4. *The Bank and the Investment Trust.* EDGAR LAWRENCE SMITH.
- Discussion.* ALEXANDER DANA NOYES. STUART CHASE.¹

SECOND SESSION

Friday, November 22, 2:30 P. M.

North Ballroom, Hotel Astor

***TOPIC: Credit Regulation through the
Federal Reserve System***

HENRY ROGERS SEAGER, *Presiding*

1. *Guides for Bank of Issue Operations.* W. RANDOLPH BURGESS.
 2. *Putting the So-called New Era to a Test.* LIONEL D. EDIE.
 3. *The Working of the Gold Standard under Present Conditions.* OLIVER M. W. SPRAGUE.
- Discussion.* ROBERT B. WARREN. RUFUS S. TUCKER.

THIRD SESSION

ANNUAL DINNER MEETING

Friday, November 22, 7 P. M.

Grand Ballroom, Hotel Astor

TOPIC: Business, Speculation and Money

SAMUEL McCUNE LINDSAY, *Presiding*

1. *The Responsibility for Credit Inflation.* GEORGE E. ROBERTS.
2. *The Present Business Situation.* HON. HERBERT H. LEHMAN.
3. *Speculation.* FRANZ SCHNEIDER, JR.

¹ Unable to attend.

The topic headings for the three sessions have been followed in printing the PROCEEDINGS, but the volume as a whole is extraordinarily unified. As more than one speaker pointed out, there are "no water-tight compartments" in questions of this kind.

The program originally prepared for this Annual Meeting underwent considerable eleventh-hour rearrangement, largely due to the upheaval in Wall Street. The Honorable Ogden L. Mills and Mr. Paul M. Warburg, who were to have presided at the Morning and Afternoon Sessions respectively, were unable to be present and their places were taken by Dr. Samuel McCune Lindsay, president of the Academy, and Professor Henry Rogers Seager, a member of the Board of Directors. Professor David Friday of the New School for Social Research, who had agreed to speak on "The Control of Speculation", was unfortunately detained, as was Mr. Stuart Chase of the Labor Bureau, who was to lead the discussion at the Morning Session.

In spite of these defections, however, the roster of speakers remains both representative and authoritative, as the following brief "Who's Who" will indicate. The list is arranged alphabetically and includes only those speakers whose names figured on the formal program.

In addition, a number of distinguished economists attended the meetings and participated informally in the discussions; their names will be found in the abstracts of the discussions.

BENJAMIN HAGGOTT BECKHART, who gave at the First Session an historical review of the recent expansion of bank credit and brokers' loans, received his A. M. and Ph.D. from Columbia University, where he is now Assistant Professor of Banking in the School of Business.

W. RANDOLPH BURGESS, who discussed Federal Reserve policy at the Second Session, is qualified to speak on this subject by nearly ten years on the staff of the Federal Reserve Bank of New York. In 1920 he became editor of the bank's *Monthly Review of Credit and Business Conditions*, and in 1923 was made assistant Federal Reserve agent. During the World War he was statistician for the Council of National Defense and the War Department, and acting chief of statistics for the General Staff with the rank of major. As assistant

director of the Russell Sage Foundation (1919-1920) he published a volume on *Trends of School Costs*. He has also written numerous articles on statistics and finance, as well as *The Reserve Banks and the Money Market* (1927). He spoke at the annual meeting of the Academy in 1927 on "What the Federal Reserve System Is Doing to Promote Business Stability".

LIONEL D. EDIE, whose constructive address on "Putting the So-called New Era to the Test" was a feature of the Second Session, is now conducting investigations under the auspices of the Investment Research Corporation of Detroit. After an experience including an instructorship in rhetoric at Colgate, his alma mater, and a year with the Intelligence Division of the United States Navy, Dr. Edie became associate professor of economics at Colgate. He left Colgate in 1922 to spend a year in the life insurance business, but returned to his academic career as professor of economics and later director of the Bureau of Business Research at the University of Indiana. In 1927 he accepted a call to the University of Chicago as professor of finance. He has written numerous textbooks and economic studies: *Current Social and Industrial Forces*; *Principles of the New Economics*; *Practical Psychology for Business Executives*; *Stabilization of Business*; *Economics*; *Gold Production and Prices*; *Money, Bank Credit and Prices*; *Capital, the Money Market and Gold*.

JACOB H. HOLLANDER, who opened the First Session with an address emphasizing the influence of pool operations in bringing about the 1929 panic, is professor of political economy at the Johns Hopkins University, with which he has been connected for more than thirty years. He has written, among other things, a commentary on Ricardo (whose letters he edited), *The Abolition of Poverty*, *War Borrowing* and *Economic Liberalism*. Dr. Hollander is among the pioneers who have carried the principles of economics from the academic world into practical affairs. He was secretary of the Bimetallic Commission abroad in 1897, and chairman of the municipal lighting commission of Baltimore in 1900. The same year he was selected by the secretary of war to revise the taxation

system of Porto Rico, and later he was appointed treasurer of the island. He carried through a successful reorganization of the treasury department and drew up the "Hollander law" which still regulates the revenue system of Porto Rico. From 1905 to 1910 he played a similar rôle in Santo Domingo, first as special agent for President Roosevelt and the state department, and later (1908-10) as financial adviser to the Dominican Republic. He has also acted as special agent on taxation in the Indian Territory, and as arbitrator in several industrial disputes.

HERBERT H. LEHMAN, whose remarks at the Dinner Session affirmed his belief in the fundamental soundness of American business, is lieutenant governor of the state of New York. He has been since 1908 a partner in the firm of Lehman Brothers, investment bankers, and is a director in various industrial concerns. In the World War he attained by promotion the rank of colonel in the General Staff, and served as assistant director of purchase, storage and traffic in the war department. He received the Distinguished Service Medal in 1919. Colonel Lehman is a trustee of the Henry Street Settlement and many other welfare institutions. In 1928 he was elected to his present office as lieutenant governor of his native state.

SAMUEL McCUNE LINDSAY, president of the Academy of Political Science, needs no introduction to the readers of these pages.

ALEXANDER DANA NOYES, who led the discussion at the First Session, has been financial editor of *The New York Times* since 1920. Previously he had been a reporter and editor on *The New York Tribune*, *The New York Commercial Advertiser* and *The New York Evening Post*. Mr. Noyes has lectured on economics at Harvard, the University of Illinois and New York University. He has also published *Forty Years of American Finance*, *The War Period of American Finance* and other books and articles on American financial history.

GEORGE E. ROBERTS, who spoke at the Dinner Meeting on "The Responsibility for Credit Inflation", has for the past ten years been vice-president of the National City Bank of

New York, and was formerly president of the Commercial National Bank of Chicago. From 1898 to 1907, and again from 1910 to 1914, he was director of the United States Mint. He writes a "Monthly Letter on Economics" for his bank and is the author of *Coin at School in Finance; Iowa and the Silver Question; Money, Wages and Prices; Economics for Executives*; also of numerous articles and pamphlets on economic subjects.

FRANZ SCHNEIDER, JR., whose address on "Speculation" concluded the Annual Meeting, is a well known newspaper man. He was financial editor of *The Evening Post* from 1920 to 1925, and since March of the latter year he has been financial editor of *The New York Sun*. Mr. Schneider was graduated from the Massachusetts Institute of Technology with a degree in biology, and has conducted investigations into hygienic conditions in various American cities. He was formerly with the American International Corporation, and has been assistant to the president of the National Securities Company. During the World War he was attached to the General Staff with the rank of major. He has contributed to *Foreign Affairs* and other periodicals.

HENRY ROGERS SEAGER, professor of political economy at Columbia University, presided at the Second Session and spoke briefly on "Some Remedies for Stock Gambling". Professor Seager is the author of widely read economic treatises and of numerous articles on economic questions, but he is more intimately known to members of the Academy of Political Science, both as a member of the Board of Directors and as a speaker at other Academy meetings.

EDGAR LAWRENCE SMITH, who discussed the relations between banking and the investment trusts at the First Session, is president of The Irving Investors Management Company, Inc. His career in business includes five years with the United States Mortgage and Trust Company, three years with Ford, Bacon and Davis, engineers, and ten years in agricultural investigations and organization work. He has published various articles on finance.

CARL SNYDER, of the Federal Reserve Bank of New York, presented in his address at the First Session the significant results of many years' investigations on the subject of "New Measures of the Relations of Credit and Trade". Formerly an editorial writer on the *Washington Post*, Mr. Snyder has for many years been a contributor to leading economic and scientific journals, and is the author of *New Conceptions in Science*; *The Cosmic Mechanism*; *American Railways as Investments*; *Das Weltbild der Modernen Naturwissenschaft*; *La Nuova Scienze*; and *Business Cycles and Business Measurements*.

OLIVER M. W. SPRAGUE, who contributed an authoritative discussion of "The Working of the Gold Standard under Present Conditions" at the Second Session, has been since 1913 professor of banking and finance at Harvard University, and held a professorship of economics at the Imperial University of Tokyo from 1905 to 1908. He is the author of several standard works on banking and finance: *History of Crises under the National Banking System*; *Banking Reform in the United States*; and *Theory and History of Banking*.

RUFUS S. TUCKER, who led the discussion at the Afternoon Session, is now economist with the American Founders Corporation, a New York security house. Mr. Tucker was formerly with the department of commerce and the treasury department, and prepared the early studies of the department of commerce on *The Balance of International Payments*.

ROBERT B. WARREN, who led the discussion at the Afternoon Session, is also with a security house, Messrs. Case, Pomeroy and Company of New York. Mr. Warren was formerly connected with the Federal Reserve Bank of New York.

If the Annual Meeting of which this volume is a permanent record has served to disseminate accurate information and to promote intelligent, useful discussion on a problem of great public interest, the credit is due to the distinguished speakers who so generously contributed of their time and expert knowledge. The officers of the Academy extend their cordial thanks to the speakers and to the members of the Program Committee. The committee consisted of the following members:

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PART I
SPECULATION, CREDIT AND BUSINESS

PANICS AND POOLS

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THE panic of 1929 will figure in American financial history as not only the most acute of the crises which at intervals during the past two generations have convulsed the security markets of this country and of the world, but as the most distinctive. Little need be said of its severity. In unexpectedness of advent, in swiftness of development, in intensity of momentum, in area of involvement, in precipitancy of fall, this convulsion stands in something of the same relation to its predecessors that the range and complexity of current business bear to the older economic pace. More impressive even than its severity is the *distinctiveness* of the 1929 cataclysm. It is perhaps true that as to ultimate cause all panics are of a kind. The theologian will point to original sin; the moralist will quote "Jeshurun waxed fat".

But the economist is less concerned with the metaphysical ultimate than with the serviceable proximate. His interest, both as a scientist and as a practical diagnostician, lies in identifying those positive elements in our financial and industrial structure which, operating upon human nature as it is, produce or make possible such lapses into economic barbarism, as gross in their way as negro lynchings or world wars.

The panic of 1929 will clearly not fit into any of the conventional rubrics. There was no exhaustion of credit nor "loaned-up" banks as in 1893. The Federal Reserve system makes possible an expansion of credit subject only to the availability of rediscountable paper and the strength of the ultimate gold reserve. As a matter of fact, the member banks were practically out of debt to the central bank; the reserve ratio stood at the conservative figure of seventy-odd, and the current price of credit was normal.

There was no currency famine, compelling general bank suspension—obscured by resort to clearing-house certificates—as in 1907. The day of such monetary strangulation is happily

over. Thanks again to the Reserve system our circulating medium is elastic to the extent of making it possible for a solvent member bank to obtain lawful money to meet any drain.

There was no collapse of commodity prices due to inflated levels, excessive production or accumulated inventories as in 1920. During the spasm, and since, the index of commodity prices has undergone little or no change.

There were no bank crashes to topple over the whole financial structure, as in the Overend, Gurney smash of 1866, the Baring failure of 1890, the Knickerbocker Trust suspension of 1907. The Hatry collapse in London may have had some sympathetic effect; and by the time the field is cleared of maimed and wounded, some fatalities may develop. But in the main it is true that the greatest panic of our half-century was neither provoked nor attended by bank failures nor business insolvencies.

There was no undue absorption of liquid capital nor of circulating credit into fixed forms of slow productivity and excessive amount as in 1857. Indeed it has been maintained with some plausibility that the past years have seen an undue diversion of capital and credit from fixed use to liquid employment.

There was no mania for bubbles with a swelling mass of undigested and indigestible issues as in other crises. Flotations were of an extraordinarily high order, both as to quality and sponsorship, and the most active speculation centered in "blue chip" issues.

What, then, was responsible for the convulsion?

The answer is simple enough. In the past eighteen months or more, tens of thousands of ordinarily sane people throughout the length and breadth of the country, in great cities and in tiny villages, from banking magnates and captains of industry to corner grocers and office stenographers, have proceeded on the mad theory that shares of stock in sound enterprises could be advantageously bought for cash or on a shoestring at any price without regard to earnings or prospects, inasmuch as the growth of the country would continuously enlarge the equity and boost the price.

There was no allowance for business fatality, for fortuitous event, for speculative manipulation, for international disturbance. The vogue of installment buying had mortgaged future

earnings; the appeal of investment trusts had depleted current savings; and the lien of subscription rights had committed prospective income. It was as unbalanced a "gold rush" as sent Illinois farmers across Death Valley or New York shoemakers around the Horn in the fifties, and the fate of the participants has been not dissimilar.

In essentials an exhibit of hysteria, the panic of 1929 and the feverish months leading up to it are certain, however, to be associated in the mind of the future historian with certain provocative causes. For months, when all the signals pointed to a developing speculative mania, we sat by in altruistic sympathy with Europe's monetary troubles and refused to raise discount rates until the speculative bit was hopelessly lodged between the public's teeth. For months we gave receptive ear to financial ballyhoos, perched on high places, who perverted a widespread public confidence in America's economic future into high-pressure selling of anything, anywhere, at any price. Most of all, for months we remained childlike witnesses to the grossest and most impudent pool operations in the stock exchanges of the land—pool operations which were entirely dissociated from the conventional defenses (establishing a market or dissipating a torpor), but were simply bare-faced, strong-arm manipulation for the rise, to which the stock exchanges either lent themselves or in connection with which they were unwittingly used.

Imperfectly understood by plain people, marked by gentlemen's agreements attended by a conspiracy of silence, the effect of pool operations for the rise was to induce millions of small buyers, whose interest as the successors of the Liberty Bond purchasers of the war period was lately the subject of such solicitude to the financial fraternity, to pay deliberately inflated prices for their purchases of shares, and to delude them by deliberately engineered price advances. If a single practicable lesson is to be drawn from the cataclysm, it is in the direction of pool operations on the stock exchanges of the United States. If a single practicable remedy is to be applied, it is in the nature of informative inquiry and regulative action by the stock exchanges themselves.

If the stock exchanges persist in the traditional attitude of ignoring the existence of pool operations, or if admitting the

fact they insist upon the usefulness or at least the harmlessness of such activities, or finally if recognizing the existence and admitting the mischief of uncontrolled pool operations, the stock exchanges profess their inability to regulate or prevent them—then, to at least one observer, rushing in with academic folly where seasoned wisdom fears to tread, the inevitable alternative is public intervention, first to ascertain the facts and second to devise corrective methods.

Even in a country as conservative as the United States and in an area as individualistic as the security market, the American people are not likely, for an indefinite time, to continue tolerant of masked mischief-making practices, as to which those nominally associated profess ignorance or impotence.

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FLUCTUATIONS IN BROKERS' LOANS AND INTEREST RATES

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I

THE topic of brokers' loans seems an irrepressible one bobbing up periodically like the proverbial bad penny to give alarm to the financial community and to disturb the otherwise serene calm of the academicians. At a meeting of the Academy of Political Science held nineteen years ago, brokers' loans, or street loans as they were termed then, occupied an important place in the general discussion which centered about the reform of the currency. In another two decades, no doubt, the subject of brokers' loans will once again be on the agenda of the Academy.

Nineteen years ago, brokers' loans were looked upon as a phenomenon intimately associated with the national banking system, under which the cash reserves were scattered among the many thousands of unit banks and deposited reserves were held as bankers' balances with banks in larger centers, mainly with New York City institutions. The New York banks, in turn, extended these balances in the form of street loans to brokers so that it came about that a large part of the credit superstructure of the country rested on brokers' loans as on an inverted pyramid. Speakers before the Academy then were optimistic in their forecasts that this situation would disappear upon the mobilization and concentration of bank reserves with a central bank. Primary reserves would thus be divorced from stock-market operations and even secondary reserves would be invested in commercial paper or bills of exchange which would come to possess great fluidity and liquidity through the rediscount and open-market operations of the central banking system.

Meanwhile the twelve Federal Reserve banks have been established, the reserves of national and other member banks

have been concentrated in the form of deposit balances with the Reserve banks, a fluidity has been given to commercial paper eligible for discount, and an impetus to the formation of a bill market. And yet the concentration of credit in the form of street loans has not disappeared. According to the statistics of the Stock Exchange, brokers' borrowings amounted on September 30, 1929, to 8.5 billions of dollars, whereas on the occasion of that former meeting of the Academy they probably did not exceed a billion dollars. Even this amount, small by present-day standards, was considered inordinately high at the time by many authorities.

II

The growth in brokers' loans and the dizzy heights recently attained must be viewed as a part of the general increase in the superstructure of credit, marked by an expansion in the total loans and investments of all banks since 1923 (by which time the aftermath of war and the post-war inflation had run its course), of approximately fifteen billions of dollars or thirty-four per cent. This incidentally is nearly twice the expansion of credit during the year and a half of the participation by this country in the World War. Since the total volume of production, adjusted for price changes, expanded by only fourteen per cent during this period, the superstructure of credit in order to have financed the business of the country adequately required an expansion of only six billions of dollars, whereas the actual expansion was nine billions of dollars in excess of this amount, and this excess found employment in loans against securities, investments and real estate loans in the absence of a commercial demand.

Nineteen years ago the superstructure of bank credit rested upon the volume of legal tender cash in vaults in addition to balances with other banks. At the present time the superstructure of member bank and indirectly non-member bank credit rests on the realized deposit balances which member banks maintain with the Reserve banks. An increase in member bank reserve balances due to gold imports, currency retirement or an increase in the amount of Federal Reserve credit outstanding (other factors remaining equal) will lead

to a multiple increase in the superstructure of credit, and *vice versa* an increase in the superstructure will require an increase in the base, though the sequential relationship is usually from an increase in member bank reserves to an increase in bank credit.

Since midsummer, 1923, member bank reserve balances have increased by approximately 500 million dollars, which permitted an expansion in the loans and investments of member banks of 9.2 billions of dollars out of a total bank credit expansion of 15 billions of dollars. Member bank credit expanded at the ratio of 18 to 1 on the basis of the increase in the base while total bank credit expanded at the ratio of 30 to 1, a ratio of expansion that was made possible by a very rapid increase in time deposits.

To understand the expansion in the superstructure of credit we must examine into the reasons for the increase in the base, i. e., the factors responsible for the increase in member bank reserve balances of close to 500 million dollars. This increase was based on the gold imports of 1923 and 1924, on Federal Reserve open market operations of 1924 and 1927 and upon a slight retirement in the volume of currency in circulation during the past three or four years. The reduction in the volume of currency and its failure to expand as bank credit increased has had a most significant effect in that it has permitted a maximum credit expansion on the basis of the gold inflow and Federal Reserve open market operations.

Once the superstructure of credit has increased, adjusting itself to the larger base, the reversal of the process and the contraction of credit is a most difficult and painful process.

To treat now of that part of the superstructure of credit utilized by brokers, total street loans on the part of all lenders (according to the data compiled by the Federal Reserve Bank) increased by five billion dollars from 1923 to 1929 as compared with an increase in total bank credit of fifteen billions of dollars. Brokers' loans increased by 333 per cent while total loans and investments of all banks increased by 34 per cent, and in each year of the period with the exception of 1926 the increase in brokers' loans has been much larger proportionally than the increase in total bank credit. From this it would seem evident that brokers' loans, although based upon

the same factors making possible a general increase in credit, were absorbing far more than their share of the available credit.

To divide the period from 1923 to 1929 into its several parts, the expansion in brokers' loans through 1924 was largely for the account of the New York banks. Loans for own account increased by 400 million dollars and loans for correspondents by 100 millions of dollars, an expansion which took place on the basis of gold imports and the open market operations of the Federal Reserve System that year. The increase in brokers' loans was fifty per cent as compared with an increase of seven per cent in the total loans and investments of all banks.

The expansion in brokers' loans in 1925 was in the main for the account of correspondent banks which increased their participation in the market by over 700 million dollars. Loans for own account increased slightly. Total brokers' loans increased by fifty-four per cent while total bank credit expanded by seven per cent. The expansion of credit in 1925 took place on the basis of a very slight increase in member bank reserves and this by reason of a relatively large increase in time deposits.

The break in security prices in the early part of 1926 brought about a decline in brokers' loans of eleven per cent but even so they ruled 1.5 billions of dollars above the 1923 totals. The decline was substantial in loans for own account, and somewhat smaller in loans for the account of out-of-town banks, while loans for the account of others actually increased. Total bank credit in 1926 expanded by three per cent, which is about the rate of growth necessary to keep pace with production.

In consequence of the open market operations of the Reserve banks in 1927, member bank reserve balances increased by 181 million dollars, which permitted an increase in the loans and investments of all banks of nearly 3.5 billion dollars. As large as was this expansion in total credit it represented an increase of only six per cent as compared with an increase of thirty-seven per cent in brokers' loans during the same period.

The year 1928 and the first three quarters of 1929 may be considered together, since both years were characterized by growing maladjustments in the credit system, with severe internal stresses and strains. One of the most portentous developments was the increase in the total loans and investments

of all banks of three billion dollars as compared with an increase in deposits of only one billion dollars. The decline in the ratio of deposits to total credit meant higher rates of interest and an inevitable contraction of credit. Further evidence of strain was the great increase in member bank borrowings from the Reserve banks, raising the total to nearly a billion dollars, or to something more than forty per cent of the reserve balances of member banks. During this time, from January, 1928, to September, 1929, brokers' loans increased by seventy-two per cent as compared with an increase in total bank credit of six per cent—a wholly unwholesome situation.

In the increase in brokers' loans of 2.7 billions of dollars from January, 1928, to October, 1929, the New York banks are absolved from responsibility. With the exception of swings of a pronounced seasonal character, loans for own account up to the time of the crisis ruled under the January, 1928, totals. On the other hand, loans for the account of out-of-town banks increased by 400 million dollars, reaching a high point in February, 1929, the month of the warning issued by the Federal Reserve Board, sagged for a time, and then recovered to another high point in September. The balance of the increase in brokers' loans is to be explained by the increase in the loans for account of others which at the time of the crisis amounted to fifty-eight per cent of the total.

Looking back over this six-year period, one observes an expansion in loans for own account of 500 million dollars, for the account of out-of-town banks of 1.1 billions of dollars and for the account of others of 3.4 billions of dollars. Fundamentally this expansion of credit, like that utilized in other employments, was made possible by *absolute* increases in the reserves of member banks, enlarged by the Federal Reserve open market policy, by gold imports, and by *relative* declines in the reserve percentages of member banks due to rapid increases in time deposits.

In this review we have not separated bank loans to brokers from loans for the account of others. Those funds, representing mainly the liquid resources of corporations and investment trusts, were derived in part from profits and in part through the sale of securities. In so far as they were derived from profits they were not directly related to the credit policies of our central

or commercial banks, but in so far as they were derived from the sale of securities the relation between these funds and bank credit policies is a closer one. Though loans for the account of others may increase without forcing an increase in member bank reserve balances, they do constitute a "contingent liability" on bank reserves and as such should be included in any discussion of credit changes in the brokers' loan market.

III

Throughout the major portion of this six-year period interest rates have responded to temporary money market phenomena rather than to fundamental alterations in the supply of capital goods or to changes in rates of time valuation. Only in 1926 might a normal situation be said to have existed in the money market. In 1924 and 1927 interest rates were low by reason of Federal Reserve policy, while in 1925, 1928 and 1929 interest rates were rising and high by reason of Federal Reserve policy which forced increases in member bank borrowings and by reason of the demands on the part of the Stock Exchange for the increasing use and retention of an unduly large share of the superstructure of credit.

The interactions between brokers' loans and interest rates are manifold, making it extremely difficult to untangle the intricately woven web of cause and effect. An increase in brokers' loans, with other factors equal, may lead to an increase in interest rates; increasing rates of interest will draw additional funds for Stock Exchange use. High call rates eventually force a security price liquidation, reducing brokers' loan totals; and with the liquidation in loans, rates of interest fall.

From the middle of 1927 to the middle of 1929 the increase in rates of interest was most spectacular, with commercial paper rates rising from 4 to 6 per cent, with the average yield on short-term government obligations rising from 2.70 to 4.80 per cent and with the call loan renewal rate rising from 4.05 to 9.41 per cent. All rates of interest, those charged on commercial loans, on security loans and the yield on bonds, have risen, responding to the change in Federal Reserve policy and the continued demand for credit. In a sense the increase in rates was an artificial situation, but no more so than the preceding declines.

The call loan rates responded not only to the factors affecting all rates but also to factors peculiar to this loan market. For example, the unprecedented differentials existing between commercial and security time loan rates arose from a certain rationing of the stock market so that brokers had to offer higher and higher rates to attract the funds demanded by security speculation, which were derived largely from industry and the investment trusts. As further evidence of control, at the time of the Stock Exchange collapse, the New York banks pegged the call rate at six per cent so that we witnessed the most precipitous decline of stock prices of which there is any record without the accompaniment of panic rates. The control exercised by the banking community over the various loan markets, over the call loan, the acceptance market, etc., has brought about a situation in which the various money markets are to a degree analagous to non-competing wage groups.

IV

Since the break in the market, total brokers' loans, according to the statistics collected from the reporting member banks in New York, have declined by 2.6 billions of dollars. This does not mean that bank credit to that amount has been liquidated, since there has been some shifting from brokers' to customers' loans. Due allowance being made for this, the actual liquidation of credit on the part of all banks in the United States probably amounts to 1.3 billions of dollars. This decline is equivalent to 2.2 per cent of the total estimated amount of the loans and investments of all banks and incidentally amounts to about 65 per cent of the total liquidation of credit in the depression of 1920 to 1921.

The decline taking place has served to clarify many fundamentals in the situation. It has demonstrated, in the first place, that the great increase in brokers' loans was a function of stock price increases and, excepting in occasional and relatively unimportant amounts, was not a reflection of loans granted against undigested securities, loans extended for the purpose of the installment purchasing of securities or for the financing of industry. The rise in brokers' loans did not reflect a new method of financing industry but an old method of security speculation. In the second place, there would be common

agreement that the Reserve banks did well in intervening in the situation in 1928 to remedy the results of their policies adopted in 1927. Whether the action taken by the Reserve banks was taken in time or was drastic enough is another question. The increase in brokers' loans as an important constituent of the increase in the total superstructure of credit was 'unsound and invited policies of credit control. Whether brokers' loans at a particular moment are too high or are rising at a dangerous rate are relative matters, relative to bank liquidity, to changes in bank portfolios, to the foreign and domestic demands on the money market. What action central banks should take depends on the attendant circumstances, but to be effective the action must be immediate and drastic.

Another conclusion to be drawn in looking over this period is that the problem of bank reserves is still with us, as in 1911, in a different guise but with the same practical consequences. This problem now has a twofold aspect. In the first place there is the effect of the open market operations of the Reserve banks on member bank reserves and so on the superstructure of credit. So potent is the effect of these operations that Dr. Miller of the Reserve Board has advocated that they be confined to very moderate proportions. The second aspect of the problem of bank reserves is the declining percentage of member bank reserves to their deposit liabilities. This has developed by reason of the differential established by the Reserve Act in the reserves to be held against demand and time deposits. There would seem to be little justification for this difference since the time deposits of national banks do not result entirely from savings. What action should be taken now that the banking system has adjusted itself to the lower reserve percentages is problematic.

Now that the crisis has passed, thought should be given to remedies to avoid a like future situation. To this end the regular session of Congress, meeting in December, will be replete with investigations of the banking system and the reasons for the stock market débâcle. If the investigations are fundamental and thorough, much good may result. Some changes in the Reserve Act might prove helpful, in the drafting of which the lessons of this experience could be applied. Extending the branch banking privileges of national banks might be of

assistance in diverting funds from the market. More important than legislation, however, is the application of the lessons of the experience to bank management. The management and direction of our banking system in the past few years leave much to be desired. The Reserve banks have not been entirely successful in developing a philosophy of credit control, due in part no doubt to the division of counsel within the system. Commercial banks, largely by virtue of extraneous circumstances over which they had no control, but partly by their own volition, have greatly increased their holdings of bonds and security loans, whose "liquidity" depends on rising or at least stable security markets. In any change in bank policies for the better, bank management is all-important and here we are reminded of a saying attributed to Walter Bagehot that not laws but administrators make for a good banking system. The administrators of our banking system have the responsibility of so directing their policies that brokers' loans may be relegated to such an unimportant place in our financial organization as to be avoided on future agenda of the Academy.

NEW MEASURES OF THE RELATIONS OF CREDIT AND TRADE

CARL SNYDER

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THESE pages represent in part the fruition of a work that has stretched out over the last ten years. It is a long time, perhaps all too long. But so large a part of the material on which it is based has been of such recent origin that each added year has been of material weight in support of the conclusions. Also, in a problem that has baffled previous investigators, it was needful to grope through a good deal of tangled and conflicting evidence to reach the open. I have stressed the difficulties and the time because the results, if established, may have wide practical import. If they seem now a little hardy, you may find that, in reality, they are rather rigid ancient doctrine in an altered guise.

The problem is the relations of credit and trade and their expression in the general level of prices—that is, the familiar Equation of Exchange of Newcomb, Kemmerer and Fisher. It is well to begin in the ancient fashion, with definitions.

For a generation preceding the World War we were accustomed in this country to think of trade in terms of such things as pig iron and its like. "Iron is the barometer of trade"—so ran the popular view. We now know that it was one of the worst "barometers" that could have been found, misleading as to time, violence of movement, and effect. I shall ask you to think of trade in terms perhaps hundreds of times as broad, trade that covers the making and sale of products reaching in value this year, maybe to a hundred billions of dollars or more, as we count them, and involving transactions of not less than a thousand billions; that is, the total exchange of all goods, services, securities and property in a nation whose total trade is possibly greater, measured in money transactions, than that of all the rest of the world put together.

Next, I shall speak of bank credit in terms largely of total

loans and investments, since these appear to afford the best practical index, or measure, that we have of the vast total of all credit by which the business of the nation is carried on.

From time to time ingenious efforts have been made to think of bank credit in other terms, as of demand deposits, or to imagine that time deposits converted into investments differ from other forms of bank credit in their effect. But these latter seem rather artificial distinctions, and have little discoverable significance in reality.

Bank credit is created whenever a bank increases its loans or investments; and this is added to a credit fund that turns over on the average possibly about twenty times a year. The varying rates of turnover of bank deposits, in Wall Street, in the larger cities, in small cities, in county banks, describe, as Dr. Burgess neatly puts it, a normal curve from near to zero to almost unbelievable velocities, possibly four or five hundred times a year; and it is of no great consequence whether the deposits are labeled "demand" deposits or "time" deposits, or government deposits.

Further, as I shall point out, of the relationships which, I make bold to suggest, seem now established between credit and trade, none is obtainable from such artificial segregations, as of "demand deposits", any more than as if we thought of trade in terms of the old pig-iron complex.

Finally, and perhaps to many still more disturbing is, may I say, the proof that our familiar measure of "general prices"—our old friends like Dun's and Bradstreet's and the Bureau of Labor Index of commodity prices at wholesale—can no longer be considered trustworthy measures of the general price level, or average of all business transactions; that is, of the varying purchasing power of money.

If we are to discuss intelligently the statistical relations of trade, credit and prices, we must, it is clear, seek far wider aggregates for our price measures and our measures of trade and, correspondingly, the broadest possible measure of "bank credit." But are such broad measures obtainable? Can we, for example, really measure trade, that is, the total of all business transactions? There have been many to doubt.

It is true that this country has, alone among all the nations, a nearly perfect register of the total of business transactions.

This is simply saying that in the United States upwards of ninety per cent, probably, of all business transactions are now effected by means of checks; and that we now have, thanks to the Federal Reserve Board, weekly reports as to something like eighty to ninety per cent of the total of all check transactions.

But unfortunately these include speculative and financial transactions, and in a year of great speculative activity like the present these latter represent at least a third of the total volume of checks. For example, checks drawn on New York City banks alone, this year and last, represent over half of the total for all the United States; and, in turn, considerably more than half of all bank debits in New York City this year will be for the settlement of security transactions alone. It is clear then that now, as always, the total of bank debits, and the bank clearings of former days, cannot be taken as a measure of the total trade in any ordinary sense. A huge part of speculation this year was, of course, pure gambling.

Neither may we take without reserve our old friend, clearings, or debits outside New York, for the recent speculative mania swept the whole country and affected bank debits in the larger financial centers, at least, almost as much as in New York. Further, for any long-term view, at least, bank debits will also be affected by changes in the general level of prices; and this influence must be eliminated if we are to employ bank debits as measures of general trade. This involves, in turn, the estimation of the true general price level.

As little may we accept for the measure of trade those familiar indexes of basic production largely dominated by such wide variables as the pig-iron type, which are usually labeled indexes of "general business," or "business activity." It is regrettable, both practically and from the point of view of statistical candor, that these mistaken labels should be retained.

Nor is there any practical need. We now have, thanks in part to the initiative of the Federal Reserve Board and to Mr. Hoover's activities as secretary of commerce, a remarkable number of series covering almost every phase of the production, transport and distribution of goods, both at wholesale and retail. Of these, something like seventy-five import-

ant series are now available monthly; and these we have grouped together into a broad index of the total volume of trade, which is now available since the beginning of 1919.

These measures are still tentative; we do not yet know, for example, what kind of weight to assign to speculative and financial activity. These are indubitably an integral part of the economic function of the nation; but their significance is greatly diminished when this activity reaches, as in the last year or two, the stage of mania.

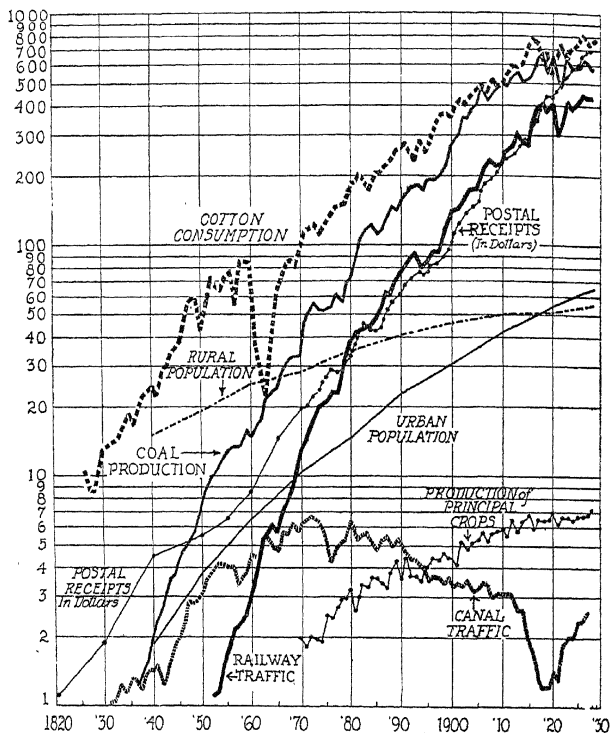
But these indexes, and still broader measures from annual data, have made clear that the actual variations of trade, taken as a whole, are slender indeed compared with the popular imagining, and that of many popular writers upon the subject. It seems probable that the real volume of goods produced and total of services rendered rarely vary by more than a few per cent from that impressively regular long-term or secular growth which, as we now know, is their most marked characteristic.

It still remains to inquire whether even these fluctuations seriously disturb the normal relations of credit and trade. Two different lines of inquiry seem to show that, ordinarily, they do not.

A number of years ago, following up the pioneer work of Kemmerer and Fisher, we attempted elaborate measures of the rate of turnover or so-called velocity of bank deposits. What we found was that in the period since the World War, for which adequate data are available, there appeared to be no discoverable long-term or secular change; but that the monthly averages fluctuated steadily about the averages for the entire period. This unexpected result appeared to be confirmed by a much more extended study from National Bank data, carrying the work back through half a century (to 1875).

But when these variations from the long-term average were plotted up, it leaped to the eye that they were, to a considerable degree, a duplicate of the fluctuations in our broad index of the total volume of trade. This is saying very simply that business activity is accompanied by a corresponding and parallel deposit activity. Obviously, if this were true, then in the equation of exchange the fluctuations of trade and the velocity of deposits appear, to a large extent, mutually com-

INDUSTRIAL GROWTH IN U.S.



This chart is designed to indicate the relatively small cyclical or short-period fluctuations compared with the persistent long-time growth of important industrial series. All of the series, except postal receipts, are in volume terms.

pensatory, and cancel out. The very high deposit velocities shown this year and last, in New York and other financial centers, were due almost wholly to speculation, and have, I believe, no other significance.

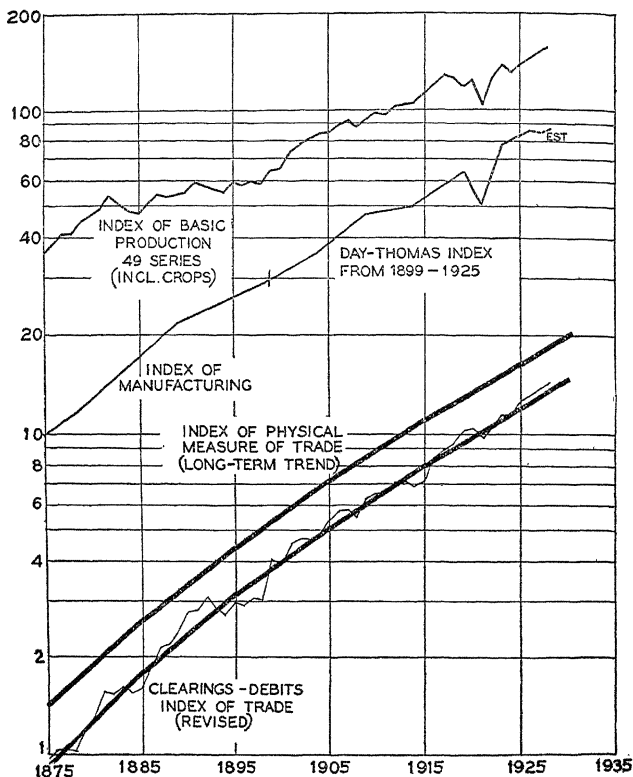
We should have, then, as decisive factors, the long-term rate of growth of trade, the parallel increase of bank credit, and the ratio between these two, which, presumptively, would be the general price level. Could this conclusion be objectively confirmed?

It was clear that evidence extending only over the last ten years would scarcely be accepted as final proof. It could only be regarded as a tentative hypothesis. And when we examine the available long-term data as to the total production and distribution of goods, we find they relate very largely to the basic production type, which we have valid reasons for rejecting as trustworthy measures of general trade. Even so broad a series as total ton-miles carried annually on our railways was inadequate, first, because it is so deeply affected by the movement of coal, and iron, and lumber, and crops; and, secondly, because its rate of growth in the sixties and seventies was far beyond any probable growth of national trade, and in later years has clearly fallen below this growth.

There remained a considerable number of physical series, such as census numbers employed in trade and transportation, horse-power used in manufacturing, number of telegraph messages, number of postage stamps sold, railway tons of freight originating, consumption of gas and electricity, and the like, which seem to afford more secure foundations for a physical index of the growth of trade. They are adequate in number and variety, but their significance as measures of trade varied slowly from one decade to another, and this is difficult to allow for. No simple method of weighting seemed feasible, and we therefore chose what I may call a chain median method, that is, taking simply the average of the central items, in their rates of growth for each five-year period. The slightly smoothed line so obtained is shown in the chart as our new index of the physical growth of trade, from 1875.

This line, so obtained, afforded a singular surprise. When we came to compare this smoothed line of physical trade with

MEASURES OF TRADE AND PRODUCTION—UNITED STATES



The graph shows the remarkable parallelism between a long-trend measure of physical growth of trade and the long-term trend of clearings and debits outside N. Y. City, divided by our revised General Price Level. A somewhat similar relation appears between these two series and an index of manufacturing—actual dollar value up to 1899, thereafter the Day-Thomas index of volume of manufacture. A slower rate of increase than in any of the other series is indicated in the index of basic production (49 items).

the long-term trend of outside clearings and debits, adjusted for price changes (and obtained by an identical formula) the resulting curves were, in turn, nearly identical. Bearing in mind the inevitable imperfections of all economic indexes whatsoever, no one would pretend that so remarkable a coincidence was not in some degree fortuitous. Nevertheless, we should expect some such result if, on the one hand, this physical measure of trade were close to a true measure and if, on the other hand, the beliefs which I have expressed in the last ten years, first, as to the measurability of the general price level, and, secondly, as to the trustworthiness of bank clearings so adjusted, as measures of trade, were sound.

The final and, as I would fain believe, confirmatory check upon these results will already be evident to those of you whose minds have run ahead of the argument. Let us review the steps:

First, the finding that in the rate of turnover of bank deposits there is no discoverable long-time or secular change. This means that between bank deposits, on the one hand, and bank clearings and debits on the other there is, for this country at least, a definite and narrow relationship, rooted, no doubt, in the habits of the people and our banking procedure.

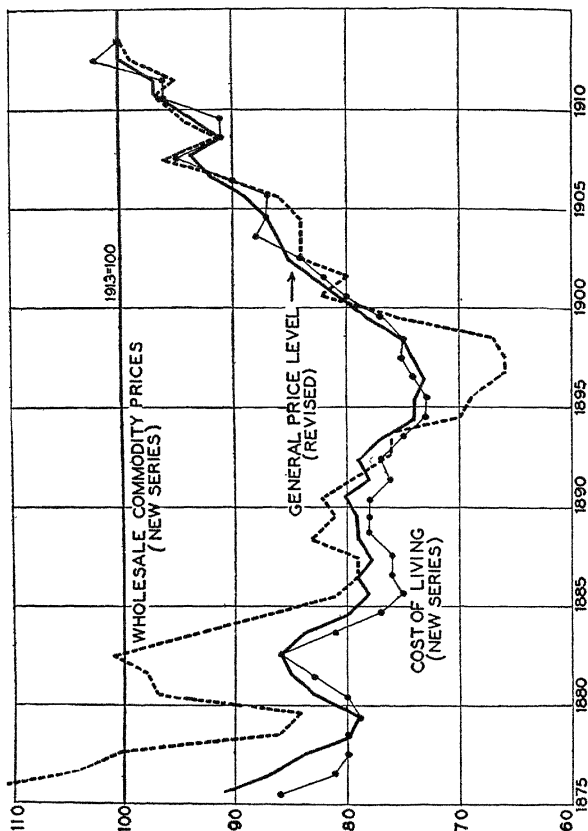
Second, a fairly close correspondence between the variations of general trade from its long-term trend of growth, and the variation of deposit activity from its long-term averages.

Third, a close correspondence between the long-term trend of growth of trade and the growth of bank clearings and debits, when the influence of price changes on the latter has been eliminated.

Therefore, the same relationship between the growth of trade and the volume of bank credit: that is, bank credit divided by the physical index of trade must yield a line closely similar to that of our index of the general price level. And this is just what we find. A graphic presentation of these results is set forth in the accompanying charts.

Observe, now, that we have made only these assumptions, first, that total loans and investments are a trustworthy index of bank credit, and this, in turn, of the nation's chief medium of exchange; second, that we may construct a fairly representative physical index of the *growth* of trade. From the

ANNUAL INDEX OF REVISED GENERAL PRICE LEVEL COMPARED WITH COST OF LIVING AND WHOLESALE PRICES—UNITED STATES



The chart shows the very close correspondence between the revised index of the General Price Level and a new index of cost of living. A similar movement but with much wider fluctuations is shown in wholesale prices.

The index of the General Price Level of seven components is a revision

ratio between these two elements we derive a kind of theoretical general level of prices substantially in agreement with a purely empirical index of the general price level, obtained by putting together all the available price indexes, both for wholesale and retail goods, for services, and for property.

In the same way we might derive the same index from the annual data as to outside bank clearings, and in this way confirm our other empirical findings, viz., that there is no long-term or secular change in the rate of turnover of bank deposits.

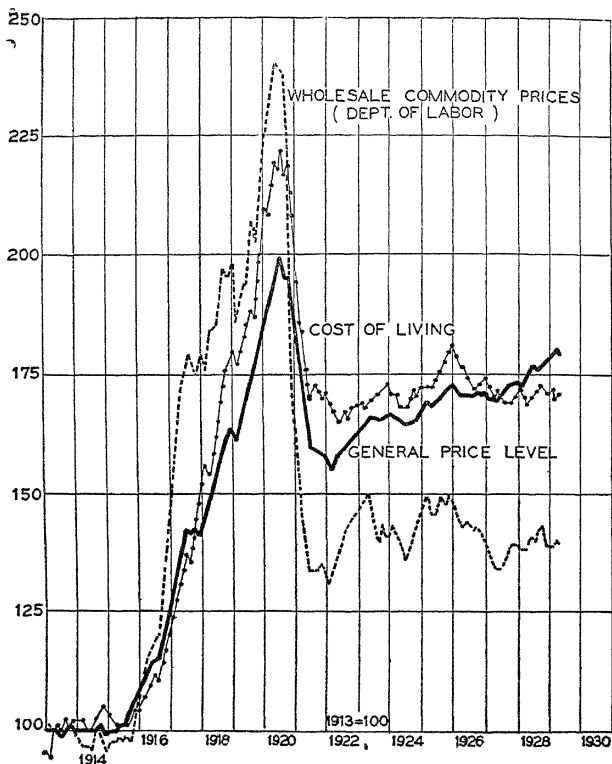
Observe, now, that we have here *five* different elements, each of which may be independently calculated, or is already found; and that each one of these five different elements may approximately be calculated from the others, given two of the other elements; i. e., we could, from the measures of trade and of the general price level, reconstruct total loans and investments; and so on.

These findings would, I believe, be impossible if in each case the measures and the data employed—the measures of trade, of velocity, of bank credit, and of bank debits, and, finally, of the general price level—were not a fairly close approach to reality. No one of these components was chosen because of, nor was its construction influenced in any wise by, any other. That they should thus interlock one with another in this fashion, each, so to speak, mutually supporting the other, would seem adequate proof of their separate validity.

The chance that in *each* of these components we should find a series of progressive or intermittent errors which in every case would very nearly compensate, each with all the others, is highly improbable. But such an assumption seems inevitable if we are to doubt the results.

Proceed, now, to the further sequence. A glance at the graphs reveals that bank¹ credit and general trade grow or increase in a very broad way together. But not evenly.

of the original index compiled by the Reports Department, Federal Reserve Bank of New York, and published in the *Journal of the American Statistical Association*, June, 1924. The new cost-of-living series makes especial use of a revision of Paul Douglas' index, 1890-1909. (See the *American Economic Review*, Supplement, March, 1926). Wholesale commodity prices, up to 1890, are those of J. L. Snider. (See *Harvard Review of Economic Statistics*, April, 1924).

MONTHLY INDEX OF GENERAL PRICE LEVEL COMPARED WITH COST OF LIVING
AND WHOLESALE PRICES—UNITED STATES

The accompanying diagram shows, by months, the movement of the computed General Price Level, compared with indexes of the Cost of Living and Wholesale Commodity Prices. Commodity prices here shown are those of the new Department of Labor index, originally on the 1926 base. For a description of the General Price Level, see *Harvard Review of Economic Statistics*, February, 1928. The rise in the General Price Level since 1928 has been due to the influence of security prices. The Index is now undergoing revision.

And whenever the increase in credit exceeds the measured increase in trade, this fact is registered in a rise in the general price level; and *vice versa*, a deficit of credit as compared with the growth of trade means a fall in prices. But by prices we are not here thinking of any special or isolated set of prices, like commodity prices at wholesale, but the broadest attainable average of all kinds of prices.

Consider, now, the implications: if these findings are true, then, so far as we can observe, there is a fixed and, in the last half-century, apparently unchanging relationship between the total expansion of trade and the need of business for credit, to carry on that expansion.

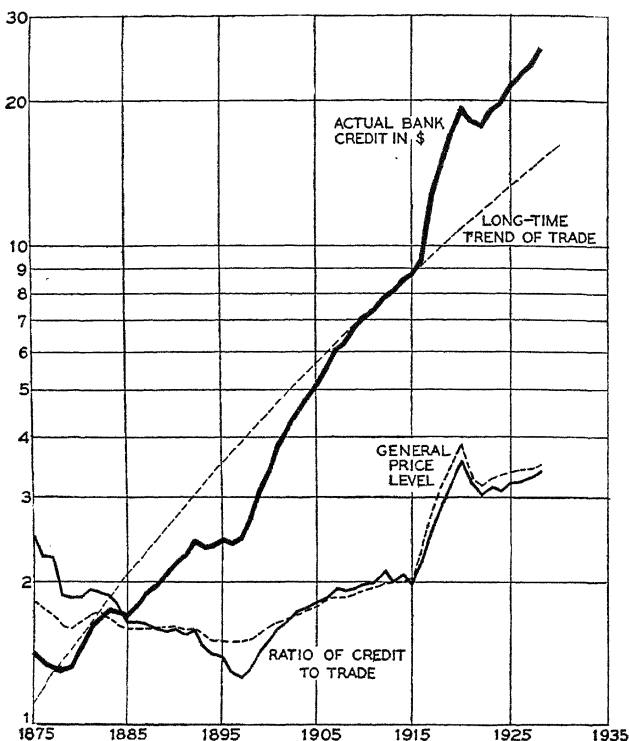
Apparently there is, under existing conditions, a fairly definite limit to the maximum rate of industrial expansion. This rate of industrial expansion is a function, first of all, of the increase of population and, secondly, of the steady advance of technology, discovery, invention and improvement alike in machinery and management. This latter shows a rising value, and expands steadily as the rate of growth of the population falls. The result, as we find it, is that over the last half-century the long-term rate of growth of industrial production has remained substantially unchanged.

This average rate of expansion appears to be, for the last half-century and perhaps much longer, close to four per cent per annum. It is a little higher in the periods we think of as prosperity, a little lower in the periods of depression. In reality, not a great deal of difference.

This steady and almost unchanging growth of the total of goods produced and consumed now practically coincides, in the last fifteen or twenty years, with the estimated increase in the volume of general trade. In the earlier periods the growth of trade, as we might expect, was more rapid.

Beginning with the immense expansion of our railway systems and the correspondingly rapid development of the country, there was a steadily widening exchange of goods. Food supplies and basic materials were drawn to the industrial centers from steadily lengthening distances, and, in turn, coal and the manufactured products shipped to greater and greater distances. Hence, the far more rapid growth of ton-miles of freight moved on the railways than the number of tons.

RELATIONS OF TRADE, CREDIT AND PRICE LEVELS—UNITED STATES



This chart shows for the United States: (1) a measure of the actual dollar volume of bank credit, derived from loans and investments in National banks (with adjustments to the rate of growth of all banks since 1913); (2) the long-term trend on a computed index (the median of five-year relatives of various measures of trade growth); (3) a computed General Price Level of 7 components 1875-1912, of 12 components 1913-1929; (4) a theoretical price level derived by dividing total credit by the trend of trade.

Hence, also, in the earlier period, a more rapid growth of trade than of total product.

With the steady industrial integration of the country, attaining now to something like a geographical equilibrium, the growth of trade and the growth of product became substantially the same.

We would expect, naturally, that the need of bank credit would, other things being equal, expand rather with the growth of trade, the aggregate exchanges of goods (and services), than with the initial product. To enforce the point, in the early days of the republic, when there were no railways and no canals and few roads, and the exchange of goods was mainly by waterways, the total of trade was absurdly small. The great bulk of goods was consumed very near to the place of their production.

When ninety per cent or more of the population lived on farms or plantations, and only ten per cent in cities no larger than Stamford or New Rochelle, there was little need for bank credit; and there were practically no banks.

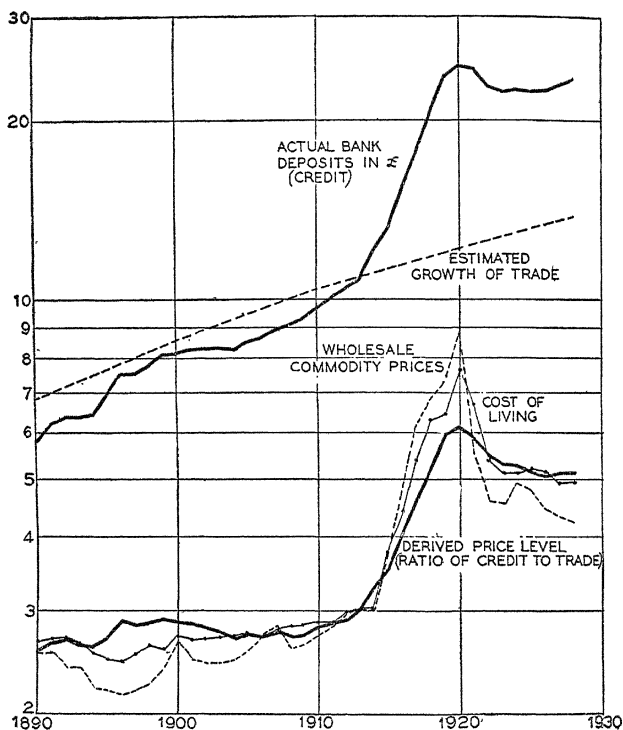
Now, we have in these computations pretty clear evidence that credit expansion must go on at least as rapidly as the growth of trade; that is, at about four per cent per year. Otherwise, there seems a definite check to trade and to prosperity.

But we seem likewise to have clear evidence that there is a sharp limitation to the beneficial effects of credit expansion, and precisely as we should expect to find it, viz., that whenever prosperity has reached the practical working *maximum of employment* for any given period, further credit expansion can only bring about undue speculative activity, and even mania, rising prices, and all the familiar ills attendant upon inflation or monetary depreciation. The gambler and the speculator thrive at the expense of the rest of the community.

Never have these theses received more vivid confirmation than in the last fifteen years. The tremendous inflation which followed the huge imports of gold in the war, and since, brought with it, as we now know, no extraordinary increase in the total of the nation's product, either in the war or in the quite mythical "new era" of the last five or six years.

On the other hand, never, perhaps, did business as a whole

RELATIONS OF TRADE, CREDIT AND PRICE LEVELS—GREAT BRITAIN



The above chart shows credit relations in Great Britain similar to those in the United States. These factors are: (1) bank deposits in the Bank of England, Joint Stock and private banks, as a measure of credit; (2) an estimated trend of trade growth derived from such series as were available for Great Britain similar to those used in computing an index in the United States; (3) a cost of living index; (4) wholesale commodity prices; (5) a theoretical price level, derived by dividing bank deposits by the trend of trade.

receive a more violent concussion, or experience more drastic losses, than in the severe deflation which followed the huge outflow of gold in 1919-1920, and the subsequent curtailment of bank credit. This curtailment was paralleled almost exactly by the most violent fall in prices which this country had known perhaps in a century; just as the reckless inflation in and after the war had been accompanied by a corresponding rise in prices.

That this could not be the mere effect of war itself is evident in the fact that the supplementary rise in the short-lived boom of 1919-1920 was the heaviest increase in the price level known in peace times in this country, at least since the Civil War.

These results, and computations, so far relate only to this country. No other has the wealth of statistical material which has made these calculations possible. May I add, however, that computations and estimates for Great Britain seem to show that much the same relationships hold for that country as for our own?

What, then, is the conclusion? If the highest national good is subserved by maintaining the practical working maximum of production, employment and prosperity, then does it not seem that, in the light of these new measures, this would be best subserved in this country by an increase of bank credit close to the working maximum increase of trade that can be maintained year after year, that is, apparently, under existing conditions, at something like four per cent per annum? And we should as carefully guard against a credit expansion materially exceeding this rate as we should jealously maintain this rate.

May we not, in the light of these conceptions, liken the effect of credit on business to that of water on an irrigated farm? An excess may be as disastrous as too little.

The further evidence seems to be that, in following the rule here proposed, we may to a large extent ignore those fluctuations in the more variable industries, which arise from over-enthusiasm or miscalculation, the current reactions from which give rise to rather hysterical beliefs that "business" is suffering.

It seems clear that no kind of bank policy could undertake indefinitely to maintain an excessive degree of speculative building, or a corresponding activity of the motor-car industry, any more than it could undertake to maintain a certain price for stocks, or wheat, or cotton, or pig iron, or, I should like to add, any fixed level of commodity prices at wholesale.

Indexes of commodity prices are essentially international price indexes, the larger part of whose components are inevitably affected by every variety of influence, and cannot conceivably, therefore, be closely responsive to credit conditions or monetary policies of any single country, even of a country so fabulously rich and occupying so commanding a position in the world's industry as our United States.

But it seems to me that this new knowledge derived from the measurements I have described does indicate that we might perhaps, without great difficulty, maintain a high degree of business stability, taking business as a whole, and therefore of employment and of social welfare. If these measures are correct, this would in turn carry with it increasing stability of the general level of prices, or average purchasing power of money. And all this would inevitably relieve business and industry from its old-time and still existent dread and fear of financial and monetary concussions; and thus give the freest rein to the advance of technology, discovery and improvement in management.

Does all this seem to you too easy; *un peu trop simpliste*, as some of you might say? May I ask you, then, to consider the question, not from the experimental or empirical evidence, but from the logic of good theory? Consider what the equation of exchange means. Is it anything more, or less, than that, as Professor Mitchell puts it, the sum of things bought equals the sum of things sold; and if things are sold for money, then for a definite sum of money or volume of currency and credit only a definite quantity of goods can be sold at a determined price and rate of turnover.

If the quantity of purchasing medium increases out of proportion to the increase of goods and services offered, must not the average of prices rise or, if you please, the value of money fall? What else is conceivable?

If, now, we find that the rate at which money, in the form of currency and credit, will function, in normal times fluctuates within narrow limits, and parallel to the activity of trade, then must it not follow that the general level of prices will correspond pretty closely to the changing volume of the purchasing media? And if we can measure the rate or growth of trade and production, then we can compare this year by year with the volume of the circulating media, and determine whether this latter has expanded at a greater or lesser rate than trade.

Have, we, in effect, found anything different from what the most orthodox of economic doctrine would require? In the light of our new knowledge as to velocity, this doctrine does undergo one marked modification. Thereby, it becomes simpler and sharper. But is this, in turn, anything more than we should expect or hope for, if, indeed, economics is ever to escape from the endless logomachy and battle of words and definitions of the schools, and take its place beside the inductive and experimental sciences?

And might I remind you, if you should, indeed, find the theorem too simple, and almost too obvious, that this is in effect the essence of most major discoveries which, like that of the law of gravitation, tend almost inevitably to substitute calculation, simplicity and mathematical certainty for hypothesis, conjecture or fantasy.

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THE BANK AND THE INVESTMENT TRUST

EDGAR LAWRENCE SMITH

President, Irving Investors Management Company, Inc.

A number of things have happened since I accepted your very kind invitation to discuss with you the Bank and the Investment Trust. In some respects, the occurrences of the last month have clarified certain aspects of the situation. But it is really too soon properly to appraise the effect of these occurrences upon the general run of investment trusts and banks.

The invitation, you must remember, came to me at the height of a New Era, an era in which many believed that what has just happened could never take place, or that at the earliest it could take place only after the volume of Federal Reserve credit in use had approached its legal limits. It is now only too evident that the New Era has come to an abrupt end, for many individuals at least. Each one of us no doubt has personal knowledge of people who unwisely placed so large a part of their back-log investments in jeopardy as collateral for stock market commitments, that when stock prices melted they lost everything they had.

Those of us who were so fortunate as to place but little confidence in the New Era have reason to give thanks to the teachers and counselors who trained us to rely upon the record of the past, rather than upon the dogmas of the moment, in the formation of policies. Others were not so fortunate, and if I quote from the past it is not in the spirit of one who would say "they might have known better," but only in the hope that before another such occasion arises we may all find more and more in the record of the past which will serve to guide us in the future. Nature is proverbially wasteful in her methods of improving a species. May those who have fallen financially find in their predicament a spur to thought and action directed toward preventing the recurrence of conditions that cause so great a loss to fall upon so many people.

In this effort, the conservatively managed bank may take

an important position—particularly in conjunction with the conservatively managed investment trust. It is with this thought in mind that I wish to open a discussion of the relations between the bank and the investment trust.

I

In discussing the bank and the investment trust as they exist in this country today, we are dealing with two entirely distinct types of financial organization: one possessing ancient and honorable traditions based upon centuries of experience and practice; the other new, a mushroom growth, which has, however, attained such proportions in the brief period of its existence that it cannot be ignored as an important factor in current financial history. Its story, though brief, has been dramatic. In the name of the investment trust, huge sums, variously estimated, but running well into the billions, were conjured up as if by magic and placed under the control of small groups of men—some of them experienced and cautious, others less so. All sorts of financial structures, some simple, some complex, some sound and some unsound, received this great flow of dollars. It is no wonder, then, that not all of the investment trusts were equally well prepared for the sudden change of scene that came with the unprecedentedly rapid decline in stock prices between September and the early days of November, 1929. By contrast, the banks, particularly those in larger metropolitan centers, under the leadership of the Federal Reserve system, were unusually well equipped to withstand the shock.

Such broad generalities do not hold at all in individual cases. But in the main, they will serve to draw an important distinction between the preparedness of the metropolitan banks and the relative unpreparedness of a certain proportion of the investment trusts—a distinction consisting not so much of differences in shrewdness and judgment on the part of individuals, as of differences in tradition and practice.

In their long history, banks have gradually formulated a tradition of conservatism which has resulted in the development of established banking practices which are brought into play as conditions warrant, and are taught by one generation of bankers to the next. Banks, moreover, have discovered the

need of coöperative action for the common good. Their competition is keen, but it is within limits, and at times it is dropped in order that the whole banking structure may be strengthened.

As yet in this country, investment trusts have not had time to develop any established practices based upon experience. The attention of each trust has been too highly concentrated on selling its own securities before the public's appetite might fail; too eager have been the managers of some to amaze prospective buyers with unheard-of gains. It is easy now in retrospect to see that some, at least, might well have drawn upon the records of the past in formulating their policies. Individually, of course, certain trusts profited by such a recourse to history, but obviously many did not.

The formation during 1928 and 1929 of one investment trust after another, each more ambitious than its predecessor, played a definite part in raising the prices of the securities in which nearly all investment trusts were interested, to abnormally high levels, just as in England a similar thing had happened in 1888 and the years following. With your permission, I will read a paragraph that might have been written at any time in the last twelve months concerning conditions in the United States, but which as a matter of fact appeared in the *London Economist* of April 6, 1889, referring to the rapid formation of investment trusts in England at that time.

Although successful with the public, the companies have not, in some cases, been able to make a very favorable start in business, for they have followed so fast upon each other's heels that they have experienced great difficulty in purchasing proper investments. The supply of really sound securities is in many directions so very limited that any decided increase in the demand at once causes a considerable advance in prices. . . . Indeed, so rapid has been the advance that it is stated several of the new trusts have been unable to effect purchases, and are now rather doubtful as to the direction in which their money shall be invested.

This comment seemed so pertinent to investment trust developments in this country during the last few years, that I included it in a brief article entitled "British Investment Trusts—A Warning", published in the *Atlantic Monthly* for October, 1927, long enough ago to have been forgotten before the organization of investment trusts in this country reached its peak in 1929, had not Paul C. Cabot quoted it again in his

article on "The Investment Trust", which appeared in the *Atlantic Monthly* for March of this year.

In the *Economist* of February 4, 1893, there is further editorial comment which could have served as a timely warning to some of our investment trust managers. It included a paragraph which might have been written with regard to the investment trust movement as a whole at the low point of the recent stock market:

Of many of the trust companies which were formed in such rapid succession a few years ago, when the mania for this form of joint-stock enterprise was rampant, it may be said with truth that, having sown the wind, they are now reaping the whirlwind. Week after week evidence accumulates, proving only too forcibly that those responsible for the management of these trusts have based no inconsiderable part of their operations upon false principles, with the inevitable result that, after a more or less brief period of apparent prosperity, losses have arisen. . . .

This paragraph was also quoted in my *Atlantic Monthly* article of October, 1927, and in Mr. Cabot's of March, 1929.

Having quoted these two paragraphs, which gave warning of the unhappy experience that faced some of the more recent investment trusts, it is only proper, before concluding with British experience, to quote once more from an issue of the *Economist* dated May 23, 1896, three years after the above quotation appeared. At this time it was possible to say:

It is satisfactory to observe that the upward movement in prices of trust securities generally, which went on more or less intermittently during the second half of 1894 and the first half of last year, has since made more regular progress, for it shows that the companies have, as a rule, improved their positions, and that investors are exhibiting more confidence in them.

There is every reason to believe, then, that most of the investment trusts capable of weathering our present storm will assume and maintain a permanent position in the financial structure comparable to the honorable position of the better investment trust companies in Great Britain.

The contrast, however, between the condition of the metropolitan banks, which were more than prepared for the severe financial strain that the recent break in stock prices placed upon them, and the condition of so many of the investment trusts, which appear to have been far less well prepared, suggests that this newer form of financial giant may profit by

closer association with organizations that have had longer experience in the ebb and flow of credit. For in the end it will be found that the ebb and flow of credit are as intimately connected with sound investment trust policies as with the successful conduct of banks. Credit conditions are of first importance in determining policies of investment management.

II

So far, we have referred to the bank and to the investment trust in general terms. In order to bring out the desirability of creating closer relationships between certain types of banks and certain types of investment trusts, distinctions must be drawn.

Among banks, on the one hand, there has become evident a tendency to expand the field of their operations, stimulated in part by the increasing interest of their customers in security markets. Thus by the early part of 1929, more than half of the banking assets of the country were concerned directly or indirectly with securities, rather than with commercial transactions. Through their trust departments, moreover, banks and trust companies are called upon to invest and manage a still greater volume of capital in which the bank has no direct interest except as custodian, trustee or adviser.

At the same time, another movement is evident, in which certain important banks have become, through their security companies, not only underwriters of new security issues, but distributors as well. Whether security salesmanship is destined to become a permanent adjunct of the banking business is not yet clear. The main point is that, as a result of their increasing interest in security markets and the economic conditions underlying these markets, banks are increasing their organizations devoted to the study of all matters affecting investment values.

The term "investment trust", meanwhile, has been given popularly so broad an application that it is at present practically without meaning. To quote from my address before the American Bankers' Association in 1927:

Perhaps we may find that it is the use of the term "investment trust" that is new and that many of the essential functions of organizations using this title have long had their counterparts in American financial organization. Whenever funds, assembled from a large num-

ber of investors, are not employed directly in the financial structure of an operating company, the intermediate structure is likely to present some of the aspects of an investment trust.

It cannot be overlooked, therefore, that investment trusts, so-called, are organized for a wide variety of purposes. Some are organized in order to give private investment bankers the command of large sums of capital, thus broadening the field of their usual activities. And where such a company, or trust, bears the name of the firm which assumes the ultimate responsibility for the management of this capital, and where the structure is simple, so that each investor may have a reasonable understanding of just what happens to his capital, then the investor has a basis upon which to decide whether or not he wishes to adventure with the firm upon the type of undertaking for which the firm has created a reputation.

On the other hand, if the name attached to a corporation or trust is designed to encourage investors to believe that they are to have the benefit of experienced, disinterested investment management applied to their funds, then some clue should be given as to the general policies which will be pursued in the management of these funds and as to the field within which investments are to be made. Probably the best way to do this is through a definite set of restrictions embodied in the terms of a trust indenture, so that a trustee may be appointed who will not only have custody of the actual securities to be held, but will also furnish a general check as to whether or not the managers of the trust are complying with the established restrictions.

Restrictions in themselves will not, however, provide sound and profitable management of funds. An investor should not rely alone upon restrictions. He must have some means of appraising the type of management which may be expected. And here, since the great mass of investors are insufficiently experienced in financial matters to form valid opinions, either with regard to such restrictions or with regard to types of management, the conservative bank has a great opportunity. The bank, with its understanding of financial practice, and with direct access to an ever-increasing number of investors, presents the logical contact between the investor and organizations designed to solve his various financial problems.

A progressive bank is always seeking the means by which it may render ever greater service to its customers. Moreover, the interests of the bank and of its customers are broadly identical. A bank will prosper as its customers prosper. The bank, therefore, has a direct interest in safeguarding the invested resources of its customers.

Under these circumstances, then, the bank becomes the logical source of advice to thousands of investors with regard to the prudent handling of such funds as they have to invest. The conservative investment trust, dedicated to the interests of investors, presents a most effective means by which sound investment practices may be applied to the resources of any large number of investors. Thus, from the point of view of the investor, the close association of a conservative bank with a conservative investment trust is logical.

This association is equally logical from another viewpoint: namely, the viewpoint of those responsible for the actual management of the funds accumulated in an investment trust. While the true investor has no interest in speculation, yet investments must be bought in a market which is greatly influenced by the activities of avowed speculators. Though not participating in these activities, experienced investment managers must know how to appraise them, in order not to invest too large a proportion of the funds committed to their care at a time when speculative activity, accompanied by the undue use of credit, has lifted the price which must be paid for sound investments so high that to purchase them would be folly. Sound banking also requires that these conditions be appraised. Sound investment management therefore can profit by the experience of the well-organized bank, and by information concerning changes in current conditions which it is the business of banks to collect and analyze.

It is plain, then, that while many investment trusts will pursue their own ends, independent of banking guidance, yet a growing number, formed primarily for the purpose of furnishing investment management effectively to large numbers of investors, will find an association with a well-rounded banking organization advantageous, both in securing the type of conservative investors that they are seeking, and in the management of the funds provided by these investors.

DISCUSSION: SPECULATION, CREDIT AND BUSINESS¹

CHAIRMAN SNYDER: Discussion of the papers of the morning will be opened by Mr. Alexander Dana Noyes, of *The New York Times*, dean of our financial writers, and unrivaled in his knowledge of our financial history.

MR. ALEXANDER DANA NOYES: The main conclusion to be drawn from the extraordinary episode of the past three weeks is best summed up in the remark made by a great social and economic philosopher, some time before our era, to the effect that "one generation passeth away and another generation cometh, and there is no new thing under the sun."

If the sequence of events has taught us anything it is that the teachings of past experience, the proved maxims of financial conduct, the established principles of political economy, apply to the business world in 1929 and will apply hereafter, as completely and absolutely as they ever applied in financial history. What we have learned is that argument based on belief that a new economic era has reversed all older economic principles is itself evidence of appeal to mob psychology. Millions of people who could not see this two or three months ago see it with perfect clearness now. I have only a few words to say respecting the most striking parts of this lesson.

First: The idea that use of credit can be boundlessly pursued, regardless of how it is used, has gone. So has the idea that exorbitant rates, such as have prevailed on speculative Wall Street loans for a year and a half, are the result of conspiracy by people jealous of the speculators' success, and mean nothing so long as borrowers are willing to pay the high rates. We now know that the nine and ten per cent money rates of a few months ago meant exactly what they meant in 1920 and 1907 and 1893 and 1873.

Second: The lately prevalent idea, that the speculating public knows the innermost facts of finance and creates real values, is shattered.

Third: Increase of a billion dollars in borrowing by stockbrokers in three months, and of $2\frac{1}{2}$ billions in a year, reflected misuse of credit in speculation, not, as was lately contended, the raising of new capital for useful industrial purposes. The fall of $3\frac{1}{2}$ billions in brokers' loans in the past seven weeks of speculative readjustment proves the truth of this statement absolutely and finally.

¹ Following the addresses by Messrs. Hollander, Beckhart, Snyder and Smith at the Morning Session, there was an extended and animated discussion, an abstract of which is given here.—Ed.

Fourth: In the talk of stocks *versus* bonds as the sole objective of private investors, the public's view is destined hereafter to be based on more judicious grounds than in the immediate past. All people have had a chance of learning that, while partnership in the country's industrial enterprises may under certain circumstances be a far more lucrative venture than the lending of private money to such enterprises, a vast deal depends, in the first place on the investors' real knowledge of the enterprise in which he hopes to become a partner; in the second, on the correctness of his judgment of the intrinsic values in which he is asked to invest; and, finally, on his realization that if the chance of paper gains is greater in a partnership, so is the chance of losses.

Fifth: The Federal Reserve's intervention during the past year and a half to arrest such use of credit by all possible legitimate means—an intervention which was denounced as unwarranted interference with the rightful purposes of an intelligent public—is now seen to have been a policy of the highest wisdom, whereby a vastly worse collapse of general credit than we have actually experienced was averted. The Reserve Board did its duty, under the most trying circumstances, and we may hope will do it again on another similar occasion.

Sixth: The public has learned and will remember for a good many years to come, that speculation in stocks on a margin, solely because everyone else seems to be speculating and making money, is the most dangerous form of gambling and a disastrous substitute for sober industry and hard work.

I shall not go into what will follow. The good points in the business situation are well known, and they did not exist in any previous Wall Street panic. They are the absence of industrial speculation during the three years in which the stock market went mad; the keeping of production in close touch with consumers' visible requirements; the absence of any general rise in prices of commodities; the almost entire lack of swollen inventories of goods which could not be sold when the breakdown of speculation came. As to just how great a slowing-down of trade is before us, we must wait and see. We cannot expect entire immunity.

But over and above all such considerations, it must not be forgotten that the making of the financial future comes in these periods of readjustment. The foundations of greater future prosperity have always heretofore been built up, always will be, and are going to be on this occasion, on the basis of the hard work, clear thinking and stimulated energy that come in exactly such periods of reaction after overconfidence as we have now entered.

MR. CHARLES EDWARD NIXDORFF (New York): There are two questions which have not been touched upon. One is why persons who regarded this drastic purge as salutary have suddenly decided that the country is in danger from its very effects. It might be that their opinion was originally based upon a desire to get in at a lower level and having gotten in, after the first break, they become somewhat afraid of their commitments.

The second question which I should like to have some economist answer is whether President Hoover and the committee with whom he is now conferring are not deceived by the famous "make work" fallacy? Is not the country going to be treated now to an orgy of simply making work for the sake of work? I hope that if economics is not purely a post-mortem science (laughter) as it seems to be, that some economist, perhaps Mr. Snyder, who seems to be as trustworthy as any (laughter), will answer these two questions. (Laughter.)

[PROFESSOR HOLLANDER, to whom the Chair referred these questions, remarked with ready wit that the conduct of post-mortems was an eminently respectable function of science, sounder and safer, perhaps, than the type of prognosis recently prevalent in Wall Street.]

PROFESSOR OLIVER M. W. SPRAGUE (Harvard University): We have here a beautiful laboratory case of the stock market's dropping apparently from its own weight. Usually such declines have been accompanied and preceded by speculation in inventories, unwise investment of capital in particular industries, overextended industrial position as regards particular concerns, exhaustion of credit, and so on. All those factors seem to be absent and we are to learn whether and to what extent a decline in security prices alone is apt to bring about industrial depression. I do not think we need expect the depression to be so serious or so prolonged as if it followed unsound development in industry.

Largely for this reason, I am inclined to think that the efforts being made under the auspices of the President to induce men to go forward courageously in carrying out the industrial plans which they had in view before this came, are desirable.

It is quite possible that mere lack of courage might cause unnecessary business inactivity. If the business structure is sound, the decline in stocks is no adequate reason why capital extensions should not take place. That, it seems to me, is what is likely to be accomplished as a result of the meetings taking place in Washington. They are not designed to carry on the stock market speculation at all. The present situation is quite different from that which would

have arisen in 1920 if similar meetings had made an effort to go forward on the then existing lines.

MR. FABIAN FRANKLIN (New York) : The second question asked by Mr. Nixdorff is a very simple theoretical question which ought not in this company to be left entirely unanswered. The question is whether Mr. Hoover's present efforts are not an exemplification of the traditional "make work" fallacy. The "make work" fallacy relates to a normal state of things; it is based on the idea that normally there is not enough work to go around, and that making more work benefits the worker even though the product is not increased. The doctrine of political economy which pronounces the ordinary "make work" idea a fallacy has no logical bearing upon the question of resorting temporarily, in order to meet an emergency, to a measure or to policies which would cause more work—productive, not wasteful work—to be done at that particular moment.

In other words, we ought not to condemn what Mr. Hoover is doing on the ground that it is vitiated by this fallacy. There may be good reasons against it—and I think there are—as well as good reasons in its favor, but it must not be in the least degree condemned on that ground.

MR. ALBERT W. ATWOOD (contributor of editorials and articles on finance and economics to *The Saturday Evening Post*, Philadelphia) : In his extremely interesting paper, Professor Hollander had the courage and the intelligence to emphasize what very few commentators in the past year or two have even referred to, namely, the part which manipulation has played in the "bull" stock market. I hope his words will have the weight which they justly deserve. But may I raise just one question? In the early part of his paper Professor Hollander said that the big collapse was not due to undigested securities and that the rise had been in the so-called "blue chip" stocks. All the compilations, however, of *The Commercial and Financial Chronicle*, of Mr. Noyes, and of others, would indicate that there has been a very large volume of security issues, nearly all common stocks, by a miscellaneous horde of holding companies, finance companies and investment trusts. If some of these issues have not been accompanied by manipulation, then there never has been any manipulation in this country. In short, I cannot quite reconcile Professor Hollander's statement that there have been no undigested securities with his statement about manipulation.

PROFESSOR HOLLANDER: Mr. Atwood's comment is very just. After all, in the course of a fifteen-minute paper in which one

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cherishes the hope that he may put the main idea clearly there is a temptation to omit the qualifying limitations which would be scientifically proper. What I meant to indicate was that in the period just passed the dominant characteristic has not been the appearance of a long succession of securities of diminishing intrinsic quality emitted by issuing houses of diminishing worth. The common characteristic of a bubble, symbolized by that immortal "flotation for purposes that will hereafter be disclosed", was singularly absent. The speculation that took place took the form rather of an overvaluation, and the manipulation occurred in the overvaluation of relatively sound securities sponsored by unusually sound agencies. But Mr. Atwood is quite right in suggesting that in train of that larger movement came the inevitable parasitic accompaniment.

MR. ROYAL MEEKER (New Haven): I would like to venture to discuss the Federal Reserve Board very briefly. It has been very justly praised by one of the speakers as a body endowed with great wisdom. I would not yield to anybody as a defender of the Federal Reserve System, but regarding the actions taken and not taken by that august body during the past year it seems to me that the question may be asked: Is it better to do the right thing at the wrong time or the wrong thing at the right time? (Laughter.) Not that it affected the Federal Reserve Board in any way, but I was in entire sympathy with the action it took or attempted to take last year and early this year in order to call a halt to the wild orgy of speculation—I believe that is the technical term that has been applied to it. (Laughter.) The action was not very effective, as you all recall. It was ineffective because the Board did not act early enough or vigorously enough. Wisdom the Board possesses. Let us hope that out of this great calamity, this purging process, it may emerge with courage to apply its wisdom a little earlier in the game.

I should like, if I still have a few moments, to ask a few pertinent questions of Professor Hollander. Perhaps I misunderstood his boiled-down quintessential statement, but I understood him to say that this crash was wholly unexpected, which was one of its peculiar characteristics. I remember distinctly at least two years ago that a great many prophets (perhaps not wholly without honor inside or outside their own country) were predicting this calamity. They said that prices of stocks were altogether too high and they advised people to sell. I took their advice and sold some and the stock went up 150 points after I sold it. (Laughter.) It was largely those cries of "Wolf!" when the wolf was relatively harmless or non-existent which led some of us to hold on to our "blue chip" stocks, our "white chip" stocks, and other colored

stocks until after the bump had been passed. Would it not be a truer characterization to say that everybody expected the calamity but everybody except the very wise, or the very lucky, hoped that the calamity would be postponed until the next high peak was reached and passed?

My second question: Professor Hollander, as I understood him, said that there was no overexpansion of credit. At least, you could imply that from what he said: that the gold reserves amounted to better than seventy per cent. Is not that an utterly misleading figure? I think it was Mr. George E. Roberts who last June calculated that the actual gold reserves against bank obligations, including notes as well as bank deposits, amounted to about six per cent. As for these extremely comforting figures of the huge reserves held by the Federal Reserve banks against bank obligations—should we not relegate them to some sort of a limbo where they will not confuse and perhaps stimulate further overexpansion?

This is the third question which I wish to discuss: I understood Professor Hollander to say that a peculiarity of this recent calamity was that there was no manifestation of "bubblemania." Then he went ahead and described in the most eloquent, telling and succinct terms just what I understand by "bubblemania." Perhaps Professor Hollander had in mind that there was not one "bubblemania," as was the case in the Mississippi bubble and the South Sea bubble, but a multitude, a plethora of bubbles. It seems to me that this period we have just passed through could very well be characterized as a "bubbling" period in our stock market history.

PROFESSOR HOLLANDER: Mr. Chairman, I beg your indulgence for bobbing up in this monopolistic way, but I should like very much to clarify any doubts which my good friend, Dr. Meeker, may have in his mind.

I think his first query had to do with the justification of my remark that the crash was unexpected. You will perhaps recall the language of his criticism. He said we were all of the opinion that the crash would come but we were all (notice the identity of the categories) of the opinion that it would hold over until the next peak. Well, it seems to me that no more effective setting for an unexpectedness could be created than by the juncture of those two states of mind.

His second comment had to do with my remark that there was no exhaustion of credit, and I indicated that by reference to the reserve position of the central bank. By an exhaustion of credit I mean such a situation as existed in 1907, a universal condition of "loaned-up-ness". No matter what the difference might be as to the actual

reserve position the fact remains that no bank was precluded from extending credit by the exhaustion of its lending power, and that definitely excludes the 1929 panic from the category of other panics, in which even gold bars could not obtain a dollar of additional credit without violation of the law.

The third comment had to do with my use of the term "bubble." I perhaps exceeded my warrant in employing it in the sense which I had supposed was generally accepted in literary discussion, meaning not the overvaluation of substantial issues but the gullibility of the public in absorbing purely fantastic and worthless securities of enterprises such as I believe figured in 1733—shipping milkmaids to Brazil to look after the herds of cows there, and exporting skates to tropical climates.

MR. C. O. HARDY (Brookings Institution): Professor Beckhart referred to the pegging of the call loan rate at six per cent. Some of us outside New York would be very much interested to have someone tell us just what did happen in the call loan market. It was a very extraordinary situation. All last winter and spring and summer, call money was worth an average of nine per cent, running up to twenty per cent. Then with the stock market panic, with brokers' loans shrinking by a billion or two a day, call money was worth only six per cent. We have been told, on high financial authority, that the panic selling was in large part due to the action of outside lenders, lenders other than banks, in withdrawing their loans at this time and forcing liquidation. Professor Beckhart referred to the fact that these outside loans were contingent liabilities of the banks.

On the face of the event, it looks as though what happened was that the nine per cent rate drew this outside money into the market and the six per cent rate drove it out again. Was no one willing, the week before last, to pay nine per cent in order to get more loans than he got? Was no one willing to meet that demand, or was the channel between the would-be suppliers and buyers in some way cut off? Did the New York banks underbid the outside lenders? And if so, why did the volume of loans shrink by a billion and a half? Or did the New York banks, as the necessary intermediaries in the case of a large proportion of the outside lenders, decide in effect not to allow more than six per cent to be paid, and not to provide as much at six per cent as the market had previously been able to get? If so, on whom does the responsibility for this shrinkage rest, on the New York banks or on the outside lenders?

PROFESSOR BECKHART: First of all, we should say that the call loan rate is established on the marginal principal; that is, a very

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small additional fund going into the market will make great changes in market rates. The marginal lenders in the market are for the most part the New York banks.

You may remember last December when the call loan rate threatened to rise to very great heights by reason of the withdrawal of funds by out-of-town banks and by others (the out-of-town banks desired to withdraw funds over the end of the year for window-dressing purposes and the others for dividend purposes) the New York banks took over the loans and put sufficient funds in the market to meet the demand at a rate which did not rise above twelve per cent. In other words, the rate was pegged at twelve per cent over the end of the year.

During the crisis and immediately preceding the crisis, rates of interest in New York fell. Rates of interest declined in early October. That is probably to be associated with the acceptance policy on the part of the Reserve Banks in building up their portfolio of acceptances rapidly and in putting funds in the market in this way which were added to the reserves of member banks and which permitted member banks to expand their own credit if they so desired.

During the crisis itself the out-of-town banks withdrew funds or rather converted their call loans into bankers' balances, because of apprehension on the part of the out-of-town banks as to the situation that might develop. Corporations drew funds out of the market not because the rate was low or because the rate had dropped, but by reason of fear of the eventualities in the situation. The New York banks took over the loans and in so doing acted with considerable courage. In taking over the loans they simply credited the deposit accounts of the out-of-town banks and the others and assumed the loan burden themselves. Consequently loans for own account between the 23d and the 30th of October, as I recall the figures, rose by over a billion dollars.

The New York banks during this particular period again pegged the rate; that is, they were willing to supply the market with funds in such amount that the call loan rate did not rise above the six per cent level. Thus notwithstanding a tremendous collapse of security prices such control was exercised that we had moderate rates of interest.

PART II
CREDIT REGULATION THROUGH THE
FEDERAL RESERVE SYSTEM

SOME REMEDIES FOR STOCK GAMBLING¹

HENRY ROGERS SEAGER

Professor of Political Economy, Columbia University

OBJECTION has sometimes been made that our programs lack timeliness. On this occasion the program has been if anything too timely, so timely that it has been extremely difficult to get the representative men whom we wished to have speak on different topics to be with us. The Academy has never had so much trouble in organizing a program and, what is quite as important, in keeping it organized.

The most serious gap in our program this afternoon is the absence, because of illness, of Mr. Paul Warburg, who was to have presided. In taking his place, I shall not venture to say anything about the operation of the Federal Reserve System in these troublous times; the speakers to follow me are much more competent to deal with that topic. Instead, may I make a few remarks upon happenings which are not unrelated to the present situation?

It is an unfortunate propensity of human nature always to look for some excuse for things for which we must ourselves share the blame. We always wish to place responsibility on someone else. We have that sort of defense psychology. We want to find a scapegoat and by condemning him to preserve our own self-confidence and self-respect.

In our present situation, Wall Street is blaming Washington, and particularly the United States Senate. The United States Senate is occupying the final days of what has proved a not over-profitable special session in castigating its detractors.

In the newspapers the craft to which I belong, the professors, have come in for some share of criticism. Some professors viewed the market situation through rosy-hued glasses just before the crash, and the financial papers, commenting on their remarks, pass lightly from criticism of individuals to

¹ Introductory address at the opening of the Afternoon Session, Annual Meeting of the Academy of Political Science, November 22, 1929.

caricature of "the professors" generally—as though we had all been imbued with the same optimism. We are too gratified to have so much notice taken of us as a craft to resent this procedure, and I merely mention it as another illustration of what we call colloquially "passing the buck".

I believe that behind this tendency to pass the buck and to personify and condemn whole groups—speaking of Wall Street as though it were one individual with one point of view, the Senate as though it were another individual with another point of view, and "the professors" as though they thought and acted as one man—is a general consciousness of guilt. Now that the excitement is over and we have time for sober reflection I want to urge more careful analysis and less hasty generalization.

As we review what has happened must we not agree that we all shared in responsibility for the phenomenal boom and for the inevitable crash which followed it? Was not the fundamental cause the desire to get something for nothing that has controlled the policies of practically every group having anything to do with the market throughout the United States? It controlled the attitude of the promoters of new enterprises. It controlled the attitude of the credulous investors who eagerly believed that they would get extravagant dividends, or that there would be continuous appreciation in the value of securities. It controlled the development of the business of stockbrokers, whose services were made available, as never before, to amateur speculators willing to venture a little and to borrow more in the confident expectation of getting large returns. In the excitement did we not all lose sight of the knowledge, confirmed over and over again by sad experience, that buying stocks on margins in the expectation of selling them at higher prices is dangerous? During the last months we have become a nation of gamblers, betting recklessly on stocks, although the law of this state prohibits betting on cards or horses.

If the underlying cause of what has happened has been the substitution on a great scale of the desire to get something for nothing for the motives which usually regulate business behavior, must we not bear this in mind in considering remedies? A good deal has been written in the last few years in regard

to the contrast between making goods and making money, emphasizing that the purpose of business is to make money, which does not necessarily result in making goods. Should we not more and more consciously accept as the guide to our public policy this thought: that we ought to control our industrial system so that making money without making goods or rendering services will become more difficult, whereas making money by making goods or rendering services will become easier?

How can this principle be applied so as to check reckless speculation in stocks? I must not encroach upon the time of the other speakers to develop this subject, and will merely mention some measures that merit consideration. The issue on a great scale of new securities of doubtful or untested value contributed to the crash. This might be checked by a thoroughgoing reform of our corporation laws, which, at least in some states, are notorious for their laxity. The ease with which new capital could be acquired caused many corporations to add to their cash resources beyond their legitimate needs and to lend their surplus funds at call at the attractive prevailing rates, free from any of the restrictions which we impose on bank loans. All agree that means must be found to control this new source of expansion. Margin trading was extended to take in the butcher, the baker and the candlestick maker as never before. We must soberly consider whether margin trading for persons of small means benefits them or benefits the market. Unless the Stock Exchange curbs this development on its own initiative, it must be prepared for insistent demands that it be curbed by legislation. Finally, must we not condemn one phase of the movement to encourage and assist employees to become stockholders in their own corporations, namely, the tendency to induce them to acquire common stock? Is such stock, subject as it usually is to wide fluctuations, a proper investment for wage-earners? Certainly many in these recent weeks have had reason to rue the day when they were led to believe so. To avoid recurrence of the catastrophe we have just experienced, we must reform our practices in these and other respects.

GUIDES TO BANK OF ISSUE POLICY

W. RANDOLPH BURGESS
Federal Reserve Bank of New York

IN policy determination the Federal Reserve System faces both an old and a new problem. It is old because there have been banks of issue in operation for many decades, including the Bank of England, the Bank of France, the Reichsbank, and others. About the operations of these banks there has grown up a comprehensive philosophy which has been written down in many books. In its major principles of operation the Federal Reserve System is no different from these other banks of issue.

The one difference which sets the Reserve System apart from these other banks and gives it a new problem is its possession of gold reserves of unprecedented size. Other differences are unimportant compared with this one.

The old rules for the operation of banks of issue were simple. At the time the National Monetary Commission was collecting information, before the Reserve System was established, its representatives questioned the Bank of England as to its policies. The question was asked, "When and under what conditions is the bank rate changed?" The answer was given, "The bank rate is raised with the object either of preventing gold from leaving the country, or of attracting gold to the country, and lowered when it is completely out of touch with the market rate and circumstances do not render it necessary to induce the import of gold." This simple rule of operation is amplified in other documents, as, for example, in the first report of the Cunliffe Committee and in the testimony of officials of the Bank of England before various Parliamentary committees.

It is not taking serious liberty with these accounts to say that the accepted credit policy might be summarized under three heads: (1) to keep the currency redeemable, (2) to protect gold reserves, (3) to lend freely at times of panic.

These were the stated aims of bank of issue policy. It is perhaps open to question whether in practice the policy conformed to such simple rules or whether, in fact, other considerations did not enter the picture. But, broadly speaking, it may be said that bank of issue policy in other countries, both at other times and even more recently, has been largely determined by the position of the gold reserves of the bank of issue. Only in rare instances have these banks possessed large enough gold reserves to permit policy determination on the basis of considerations other than the protection of reserves.

The old rules for banks of issue are not sufficient guidance for the Federal Reserve System in its present position. Its gold reserves are so large that the country could be flooded with credit before it became necessary to raise rates to protect reserves. To do so would involve the country in a fearful inflation. Some would perhaps argue that world recovery might have been more rapid if this country had allowed imported gold to expand credit to the maximum, but certainly majority support could not be obtained for that point of view. The result of such a policy in terms of credit inflation and later deflation would be too severe to contemplate seriously. Clearly some other principles of policy must be evoked besides that of protecting gold reserves.

Thus the Federal Reserve System has a unique responsibility but a unique opportunity. Its policy can be determined not by what it has to do, but by what is best for it to do for the well-being of the country. Discount rates and open market policies can be governed on the basis of what appears to be the wisest policy in the best interest of business and trade.

In a sense the Federal Reserve System has been sailing upon uncharted seas, for its policy could not be determined by the old rules. The question which must be answered is how much credit is good for the country and what restraints should be put upon its use. In the abstract this is a complicated and appalling problem, as difficult as trying, for example, to say what the amount of brokers' loans should be.

Fortunately the problem does not have to be settled in abstract terms, but always appears in actual situations. When a board of directors of a Federal Reserve bank or the Federal Reserve Board sits about the table discussing the discount rate,

it does not have to decide in the abstract how much Federal Reserve credit should ideally be employed, but rather faces the question whether in an existing credit situation easier or firmer credit seems desirable. That is not so difficult. For example, some months ago it seemed clear that a policy of restraint in the use of credit was desirable, for the speculative use of credit was increasing more rapidly than could possibly be maintained for an extended period without trouble.

Despite all modern progress in economic science and practice, the business cycle continues to be a dominating phenomenon in American economic life. There continue to be recurrent tendencies for business to operate now too slowly and now too rapidly, for producers or distributors to overestimate or underestimate the demand for goods, for speculators to be overoptimistic and overpessimistic as to the future. While the steady growth of the country is evidenced by a constantly expanding economic life, a constantly enlarging production of goods, a constantly growing stream of goods distributed, the movement forward is not continuous, and the curve of actual economic activity from month to month seldom coincides with the smooth upward curve of progress, but at any given moment is either above it or below it. Business is moving at any given time more rapidly or more slowly than the pace which it can maintain. It is either in excess or in deficiency. These fluctuations have perhaps been reduced in size recently, but recent experiences make it clear that they have not been eliminated.

Greater economic stability and more continuous prosperity depend on curbing the excess and stimulating the deficiencies of business, and especially upon curbing the excess, for overproduction and overspeculation are the forerunners of business depression, unemployment and distress.

It is at this point that a bank of issue, and particularly a bank of issue in this country under present conditions, should perform its most useful service, for easy credit is a stimulant and tight credit is a depressant, and the bank of issue can throw its influence toward easy credit or tight credit. This influence is only one of many. We have learned to our cost that the bank of issue acting alone cannot check all excesses. But it has an important influence.

This general principle was clearly recognized in a report on

the problem of unemployment made by the President's Committee in 1923 in the following paragraph:

Credit conditions are of major importance in the upward movement of the cycle and in precipitating the decline, so that the first and most important method of controlling the cycle and preventing excessive expansion should be found in the fundamentals of our banking situation. Control of expansion so that production is allowed to increase and business is actively stimulated to a proper degree, while expansion is checked at the stage when it becomes dangerous, is a fundamental principle already accepted by bankers.

It is not impossible at any time to decide whether business needs a stimulant or a depressant. With the wealth of statistics now available we know for most lines of business and trade the usual rate of growth, and the figures tell us from month to month whether we are ahead of or behind that line of growth. We know that bank credit normally grows at the rate of four or five per cent a year, and excessive growth beyond that rate or deficiency below that rate is a signal that the credit situation it to be scrutinized with care. With the guidance of such statistics experienced bankers and business men can recognize without serious difficulty when business is in the prosperity or depression phase of the business cycle.

In fact, the history of Federal Reserve credit policy in recent years, as we look back on it, shows that the Federal Reserve System has in general exercised restraint at times of excess and has provided the stimulant of easy credit in time of deficiency. In the speculative boom of 1919-1920 the system used discount rate increases and other methods of restraint. In the depression of 1921-1922 they applied the stimulus of low discount rates and of putting money into the market through the purchase of government securities. In the spring of 1923, when boom conditions began to develop, they raised rates and sold securities. In the mild depression of 1924 they reduced rates and bought securities. In the speculation of early 1925 they raised rates and sold securities. In the mild depression of 1927 they reduced rates and bought securities. Against the speculative enthusiasm of 1928 and 1929 the system interposed the restraint of higher discount rates, reduced open market portfolio, and repeated admonitions.

In citing these facts I do not want to suggest that the Federal

Reserve System has been wholly successful in achieving the aim of the policies adopted. What can be said in reviewing the history of this brief period is that the direction of movement of Federal Reserve policy has been in accordance with the general principle of exercising an influence toward restraint in periods of excess and stimulation in periods of recession or depression. The size of the dose of firm money or easy money may at times have been too large or too small. The precise timing of the action taken probably could have been bettered with the wisdom of hindsight. What these facts do show, however, is that the principle we have been discussing is sufficiently practical and sufficiently clear so that it has in general been followed by the Federal Reserve System.

There are a number of corollaries to this general point of view about the purpose and nature of bank of issue policy. The first is that as the bank of issue seeks to adapt its policy to changes in business and credit it cannot seek as its primary aim stability in money rates. At times when the country's economic life is moving too rapidly and is colored by speculation and excesses of one kind or another, the Federal Reserve System or any bank of issue may have a duty to make money rates which are already high, higher still, and conversely, it may be the duty of the bank of issue to make money rates easier at a time when they are already easy.

The Reserve system has peculiarly a duty to perform in this connection, for its very presence has modified the automatic working of some of the old relationships of credit demand and supply. In the old days the country's reserve supply of credit was so small that any economic excess promptly used it up, and money stringency checked the excess. The mechanism of the Federal Reserve System has made large supplies of credit readily available and thus the old automatic check has been largely replaced by a voluntary check. In using its influence toward firmer money at times of overstimulation the Reserve system is doing no more than supplying an artificial substitute for an old corrective which the coming of the system weakened. There are times no doubt when stability of money rates is desirable. The stability of rates, however, is not an end in itself but simply a means to an end. The real object is sound credit and business conditions and this object may at times be

aided by forcing rates to high levels or forcing them to low levels. It is often the duty of the bank of issue to lend money freely when there is little demand and withhold it when the demand is most clamorous.

The second corollary of this general theory is that a bank of issue is usually working in the opposite direction from public psychology. At times of speculative enthusiasm the bank of issue is always holding back. At times of gloom and pessimism the bank of issue is usually encouraging. This opposition to the popular trend is a considerable handicap to popularity. Fortunately, the world is progressing in its economic education so that the value of restraint of overenthusiasm is becoming recognized by the wiser and more conservative. In times when credit restraint is necessary the bank of issue must rely on the support of a conservative minority, consisting principally of those congenital pessimists, the economists and the bankers. But during those brief periods when it becomes the duty of the bank of issue to lend its influence toward easy money, the bank of issue can for the moment bask in the warm approval of the business man, the entrepreneur and the speculator.

PUTTING THE SO-CALLED NEW ERA TO THE TEST

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IT is a commonplace that during recent years important developments have taken place in business methods, such as hand-to-mouth buying, industrial research, production schedules held in balance with consumption, rationalization of output. These changes have given rise to the term "the new era".

During recent months this new era has been subjected to a most severe test. When any institution is severely strained, its weakest side is likely to be most affected. In this case, the financial side of the new era was the weak spot. In general, bank management had not gone through the same rigid cost analysis and operating efficiency improvement which had been realized in industry. Rationalization of output had not been applied to capital raising and credit creation. Whereas in industry inventories had been carefully restricted, in finance huge inventories of undigested securities had been allowed to accumulate. The principle of stability had not received the same earnest thought in financial markets as in merchandise markets.

This was illustrated in the report rendered by President Hoover's Committee on Recent Economic Changes. In this elaborate two-volume work on the new era, only one chapter was devoted specifically to recent financial changes, and in this chapter only four pages to the security market.

The whole structure has just been exposed to a stock market crisis of extreme severity. We have been congratulating ourselves that there was no panic of the 1907 variety. There was not a money panic, that is true. Yet there were days when only a very thin wall separated us from an old-fashioned run on the banks. What actually happened was not a currency run on the banks but a movement in the opposite direction. The banks made a run on their customers. There were no bank failures, but there were plenty of customer failures. The liabilities of the customer failures would compare favor-

ably with the usual liabilities of bank failures in an emergency of this kind. The banks saved the situation and saved themselves at the expense of the customers.

These events raise the broad question whether such violent movements in capital markets are an inevitable part of the modern economic order. Must it be true that even though industry and trade yield to a higher standard of efficiency and stability, the capital markets cannot be brought within the limits of similar intelligent rationalization? I know of no economic question of greater importance.

I recently had occasion to read the annual reports of the Bank of France back to 1900 and was deeply impressed by the fact that this great institution has long conceived one of its primary functions to be the prevention of crises. A seasoned, conservative institution, rich in tradition and background, the Bank of France recognizes that the function of a central bank is to prevent crises. Recognition of this function is more or less common among European central banks. It is a sort of irreducible minimum.

In the United States, responsibility for this specific function is not clearly and definitely acknowledged. Hence, even after our great banking reform legislation a decade and a half ago, we have been exposed to repeated crises of a most serious character. In 1920 we had a crisis which received its initial impulse from an over-loaned condition of the banks on excessive inventories bought at inflated prices. Swiftly following this commodity crisis, there came an agricultural crisis which was protracted over many years and was associated with bank failures on an alarming scale. In 1927 a real estate boom culminated in the Florida land crisis. This year the crisis struck in the field of stock-market speculation.

Can a central bank properly concern itself with the prevention of such crises? What are the limits within which the Federal Reserve System can safely operate with respect to such financial developments? In attempting to answer these questions, let us first have in mind the essential characteristic of a crisis. This essential characteristic is forced selling on a falling market in order to pay debt and remain solvent. The selling is forced by the demands of creditors who have loaned heavily against collateral in the form of commodities, real

estate, securities or some other form of property. The forced selling itself intensifies the falling market. For as each additional wave of selling increases supply, sellers become frightened lest if they do not sell immediately they will face still lower prices tomorrow. The owners of commodities, real estate, securities or whatever form of property is involved are threatened with bankruptcy unless they liquidate at once and get out of debt with the banks. To repeat, therefore, the essential characteristic of a crisis is forced selling on a falling market to pay debt and remain solvent.

In 1920, manufacturers and merchants were forced to sell commodities when prices were plunging downward and to use the proceeds to pay banking and trade creditors. In 1921 and later years, farmers were under pressure to sell land on a sagging market and so to struggle against bankruptcy of themselves and of country banks. In 1927, it was land which had to be liquidated in a collapsed market to pay debt. In 1929, it was securities which were sold out on a frightened market in the desperate effort to meet debts outstanding.

The prevention of crises of these types requires the prevention of the conditions which make crises inevitable. It requires the prevention of a train of circumstances which lead toward an unstable market position. These antecedent circumstances run according to a fairly simple and standard pattern. In simplest terms, every crisis must be preceded by rising prices of the goods or properties in the given market, these rising prices being supported, made possible and even stimulated by bank credit. The prices rarely if ever could go through the rising wave if they were not aided and abetted by bank credit.

This process is quite confusing to those who are accustomed to think in terms of the orthodox law of supply and demand. It is, indeed, quite the opposite of that law as commonly understood either by the man on the street or by the academic economist. As commonly understood, the law means that a rise in price will make sellers offer more supply and will cause buyers to demand less. The higher the price the greater the supply and the less the demand. Our textbooks are filled with graphs illustrating this law and our newspaper editors and business review writers are so prone to tell us that neither

individuals nor politicians can successfully violate the great law of supply and demand that someone has said we can make an economist of any parrot by teaching him to say the law of supply and demand. Any exception is usually relegated to a trivial footnote or, to use the phrase of an American economist, dismissed to the penumbra of the subject.

But when we come to discuss the meaning of crises, the exception becomes the rule. This requires explanation. Consider the period during which the way is being paved for a crisis relating to commodity markets. Some early impetus to price leads buyers to fear a shortage of a given commodity and an expectation of a higher price. Their strategy is, therefore, to buy a large supply in advance of needs, getting the commodity at today's low price in order to avoid next month's higher price. Clearly, here the higher the price, the greater the demand. This is just the reverse of the great law of supply and demand as commonly defined, which declares the higher the price the less the demand.

It was the same in the farm land boom. Price advances led to expectations of further advances. People bought the more heavily as prices moved upward. Higher prices meant greater demand, not less.

The supply-demand relationships leading up to the late unpleasantness in the stock markets are of like character. When common stocks were lifted to sell at twelve times earnings, the expectation that they would go still higher meant that the high prices caused greater demand instead of less. Then prices rose to fifteen times earnings, and so on up. The law of supply and demand, as usually understood, was working in reverse.

Now, this behavior of supply and demand is typical of all pre-crisis periods so far as I can discover. It is typical of commodity booms, building booms, land booms and security booms.

If we are ever to prevent crises, we must devise ways and means of preventing this sort of supply-demand behavior from running to extremes. The static economic law is inadequate, as we have found repeatedly that a high price does not check demand in such periods and does not put supply in a stable relationship with demand. Rather, a high price in such periods

acts as an alcoholic stimulant to further extremes of demand and puts supply farther than ever from stable levels. Is there any method of prevention of these cumulative developments?

In answer, we must turn to the part played by bank credit. It is possible in such periods to shoot prices up because buyers expand their purchasing power from loans. Bank loans made possible the commodity inflation of 1920, the land inflation of 1920 to 1927, and the security inflation of 1927 to 1929. Buyers would exhaust their purchasing power rather quickly if the banks did not replenish it. A real degree of responsibility therefore comes back to the banking system of the country. The bankers cannot escape this responsibility. If any power can prevent the conditions which lead to crises, that power lies with the banking system.

Let us summarize up to this point. A primary function of a central bank is to prevent crises. The essential characteristic of a crisis is forced selling on a falling market to pay debts and escape bankruptcy. The period preceding a crisis is marked by rising prices supported by bank credit. During this period, the law of supply and demand so operates that each rise of price instead of checking demand stimulates further demand. The cumulation of this process is made possible by the new purchasing power made available to buyers through increased bank loans. The banks thus play an essential rôle in the circumstances which later make a crisis possible.

This brings us to the crucial problem: Is the prevailing American philosophy of the proper relation of the Federal Reserve banks to speculation in Wall Street wise and sound? In dealing with this problem let us not indulge in intolerant criticism. I have no desire to engage in the cross fire of partisan attack and defense of the Federal Reserve, but I do think that we may well reëxamine the course over which we have traveled of late years with a view to finding whether our central banking philosophy is adapted to the prevention of crises. I shall have particular reference to prevention of crises in the security markets.

If one goes back to the philosophy of the framers of the Federal Reserve Act, one finds certain simple, definite ideas. It was claimed that Wall Street tended to absorb too much of the money of the country and it was expected that the estab-

lishment of twelve Federal Reserve banks would decentralize money supply. Everyone knows how thoroughly subsequent history has destroyed this original conception. But it was further claimed that the Federal Reserve should not furnish credit for speculative purposes. As time has gone on, the idea seems to have become that the central banks should not let speculation enter into the determination of their policies. It is said they should not think about speculation. Let them think about the needs of trade and let speculation go whithersoever it may.

Now this naïve doctrine does not seem to me to be sound economics or wise policy. It is a relic of the old cleavage between the West and Wall Street. It is a left-over of the provincial philosophy of a militant interior warring against the money power of the East. As nearly as I can discover, there is no similar doctrine accepted in the older financial centers of Europe. It is a doctrine peculiar to a country still profoundly influenced by an agricultural democracy. Although historically explainable, the doctrine does not square at all with the real nature of the American money market.

It is quite impossible to purge central bank policy from all consideration of speculative conditions in a country where the chief money market is a call-loan market intimately tied in with the stock exchange. In no other large country does the call-money market for security loans play such a relatively important rôle. In experience, the Federal Reserve Bank of New York has found it necessary to study carefully the operations of the call-loan market. It is a well-known fact now that the day-to-day rediscount requirements of New York member banks are closely interrelated with the day-to-day deficit or surplus of reserves of those banks and with the ups and downs of the call-loan rate. The 1928 annual report of the Federal Reserve Board frankly admits the error in the old concept of water-tight compartments as between Wall Street and the rest of the country. Not only is the attempted separation of security market and bank policy historically obsolete and financially impracticable, but also it is utterly impossible when a crisis actually arrives.

When a crash comes in Wall Street, Federal Reserve banks are expected to step in and to play a courageous and heroic

part. I think everyone admires the manner in which the Federal Reserve banks came to the rescue during the last week in October, 1929. Furthermore, Federal Reserve banks are asked to help repair the damage after the storm has passed, to mitigate the harmful effects upon business, and to restore a healthy condition in industry. In other words, we insist that the Federal Reserve shall assume responsibility in the midst of a crisis and in the period of convalescence after the crisis, but according to our traditional philosophy, we have not been willing to assign them the responsibility for the prevention of a crisis. We must come to the principle that the function of a central bank is to prevent crises.

• The existing substitute for this principle is quite inadequate. This substitute principle seems to be that the Federal Reserve should interfere only after the stock market has begun to draw funds away from trade and industry. What will be the earmarks of such a condition? As I understand it, the primary symptom would be any tendency for member banks to rediscount and to use the funds for call loans or customer loans on securities.

Now, this signal is hopelessly inadequate. It is wholly possible for rediscounting banks to be keeping their speculative credits down, while other banks are expanding their speculative credits rapidly. It is entirely possible for a dollar of credit initially made for trade and industry to drift by natural processes of circulation into the security market. This process of indirectly feeding funds into the stock market can go on for some time and reach an acute stage before evidence begins to show clearly that the stock market is draining money from industry or that Federal Reserve rediscounts are being used as a feeder for the speculative money market.

What has actually tended to happen is this. Our central banks have inadvertently poured fuel into the speculative burners and at a much later date have tried vainly to put out the fire. When the central bankers insist that they cannot take speculation into account, we can be pretty sure that unconsciously their policy is resulting in the groundwork of a new outbreak of speculative activity based on bank credit.

Does this mean that the Federal Reserve should assume responsibility for stabilizing completely Wall Street speculation?

Absolutely not! Nor should any opportunity be left to the public to assume that somehow the Federal Reserve will protect them from their own speculative follies and excesses.

What a central bank can do is to prevent the expansion of credit for the creation of those conditions which finally make possible a stock market crisis. Probably adequate defense can be given for the lowering of the Federal Reserve rate in 1927, but it is hard to conceive of any adequate defense of the failure promptly thereafter to advance rates more decisively with a view of "scotching in the shell" the speculative fever that was being born at that time. This observation may be made without in any way endeavoring to make carping criticism of the Federal Reserve. In this spirit, I feel warranted in saying that although the Federal Reserve performed heroically in the midst of the recent crisis and will doubtless do all in its power to repair the damage of the crisis, it cannot point to the same record of achievement in preventing the crisis. In making any such observation, one must think in terms of the whole period from 1927 to 1929 and not merely in terms of the few months preceding the crash this year.

The weapons for prevention of crises are mainly threefold: moral suasion, raising the rate, and regulating the reserve. In the past moral suasion has been less effective in this country than in other countries because of our system of independent banks. In the larger countries abroad, a central bank can confer informally with a few leading bankers and give a warning that too much credit is being put out for this or that purpose. These leading bankers control so many branch banks that their willingness to follow the warning is reasonably effective. Moreover, there has grown up a tradition in foreign banking circles to the effect that the big banks must play the game with the central banks when such a warning is given. In this country, the lack of concentration in banking has been a handicap to moral suasion. But perhaps even more of a handicap has been the absence of the tradition which called for playing the game with the central bank. However, even though we face these handicaps in the United States, when moral suasion breaks down, raising the rate is a more tangible weapon. Now it will be said that raising the rate in order to punish the stock market will also have the effect of penalizing

business. The answer to this point of view is that a gradual slow process of advancing the rate would have a stunting effect on business, but a sharp and swift advance in the rate would have the affect of checking the false inflation in security markets without paralyzing business. In this respect there has grown up since the war, both in this country and in England, a false feeling that a change of the discount rate is somehow an evil thing. Stability of the discount rate has been put on a pedestal. Probably not a little of our difficulty comes from this false idea. When moral suasion fails to prevent those conditions which may lead to a crisis in the security market, then it is time for a decisive advance of the discount rate and tightening of the money market. At such time, stability of the rate can only lead to a cumulation of those stresses and strains which will finally develop into a crisis.

As soon as such a decisive advance in the rate has worked its influence upon the security market, then the rate can properly be lowered so that business need not be unduly hampered.

In addition to moral suasion and raising the rate, there is the weapon of regulating the reserve. If the reserve is restricted by the central bank so that credit does not suddenly shoot ahead of a normal rate of growth, the chances of speculative conditions' being carried to crisis proportions are small. In fact if this part of the situation is adequately handled, the other weapons of prevention, namely moral suasion and raising the rate, are relatively easy.

I shall not pursue this phase of the problem further because I am interested now in establishing the principle that the prevention of crises, including stock market crises, is a function of the central bank. The good parts of the new era cannot give society much profit unless the financial side of the new era comes in for more thorough rationalization.

In conclusion, the central banks should assume responsibility for attempting to prevent crises. This attempt should include stock market crises as well as others. There are certain conditions which give the problem a peculiar slant in the United States, but in spite of these it would seem that our central banks have not yet realized their full opportunities and responsibilities for the prevention of business crises. If the philosophy of the past is to prevail in the future, then we must look

forward to repetitions of the disaster of 1929. Without attempting to criticize or to blame, I think we should be willing to reëxamine the premises from which central bank policy has proceeded and set up as an objective for the future a prevention of rapidly rising prices fed and nourished by too much bank credit. If moral suasion is ineffective, then the discount rate should be courageously applied. If this application is timely and sharp there is every reason to believe the conditions of crises can be "nipped in the bud", so to speak, without greatly retarding the smooth course of business prosperity. It is a function of the central bank to prevent crises.

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THE WORKING OF THE GOLD STANDARD UNDER PRESENT CONDITIONS

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THE gold standard has emerged triumphantly from the welter of disordered currencies of the World War period and gold has now become more universally than ever before the foundation of the structure of credit throughout the world. This return to the haven of familiar monetary practice is significant of the widespread conviction that the gold standard is an essential factor in the maintenance of a reasonable measure of international financial stability for which there is no promising and practicable substitute. Aside from the defect, perhaps not incurable, of long-time secular price trends, the gold standard worked well during the half-century preceding the war and the public is hopeful of not less satisfactory results in the future. That these hopes can be realized, I am firmly convinced, but under present and prospective conditions they can be realized only through a greater measure of coöperation and conscious effort than was required under the conditions that obtained in the pre-war period.

Deferring to the close of this paper the problem of secular price trends, I shall first discuss the gold standard in operation as through gold movements, actual or anticipated, it affects the supply and cost of credit and brings about changes in economic and financial conditions. Between countries that are on the gold standard forces are constantly at work tending to check any wide departure from an international equilibrium of payments. When the causes of disequilibrium are not of a deep-seated nature involving difficult and far-reaching readjustments, industrial and financial, the corrective process through the operation of the gold standard is in large measure impersonal and even automatic. Gold exports, not so much because they are a means of payment, but through the restraining influence which they exert on the countries losing the gold together with the easing of the money markets of the

countries receiving it, are an effective means of correcting those slight departures from equilibrium that are of constant occurrence in the ordinary course of international trade and other foreign transactions.

During a long period of years preceding the World War, a continuous series of slight, or at all events by no means extreme, adjustments was characteristic of the international economic situation and the influence of gold movements of quite manageable proportions was sufficient to maintain the nations in financial equilibrium. But now the gold standard has been restored to a world that is by comparison at a far greater remove from economic and financial equilibrium; to a world also in which international payments of great magnitude and largely of non-economic origin are to be made over a long series of years. The situation would clearly seem to be one in which anything approaching the automatic operation of the gold standard might be expected to involve stresses and strains so severe as to threaten the breakdown of the machinery of credit. There are limits upon the amount of gold that can be withdrawn for export without endangering confidence in the credit structure and there are also limits upon the possibilities of credit contraction and consequent shrinkage of values if disastrous industrial dislocation is to be escaped. On the other hand, gold inflows may be of such magnitude as to threaten serious inflation if the gold is fully utilized as a basis for credit expansion. And yet, if the gold is not thus employed, the extent of the necessary readjustment is widened in the gold exporting countries.

Payment of reparations and the interallied debts together with changes in trade channels, more and higher tariff walls and much foreign borrowing of a more or less distress character all combine to create a situation in which less reliance than formerly can be placed upon the unfettered working of economic forces and particularly upon those of a monetary nature. It is a situation that demands the adoption of concerted policies based upon intelligent foresight and adopted well in advance of the appearance of emergencies. Indeed, the international position at the present time seems not unlike that of business enterprises which have promising possibilities but which require time to work themselves out of an unsatis-

factory situation. The application of such basic and time-consuming remedies as the development of new industries and improved methods of production can only to a limited degree be hastened under the spur of monetary pressure and may be indefinitely deferred if that pressure is extremely severe.

In addition to these familiar conditions that must render the establishment and maintenance of an international balance of payments an exceptionally difficult matter in the immediate future, there is still another factor militating against the smooth working of the gold standard that is perhaps less generally recognized. I refer to the effect of the presence of the United States as a creditor country and to the functioning of the New York money market as a world money market. On the basis of recent experiences, it is hardly too much to say that the United States is a most unsatisfactory creditor country from the point of view of the rest of the world. This is due to the fact that we are only intermittently a creditor country. In the good old days prior to the war, capital was largely distributed throughout the world through the London investment market, and a supply of funds for long-time use in foreign countries was always available. The domestic demand for capital in Great Britain and in the neighboring countries of the Continent was fairly stable and never approached the aggregate of current savings signifying investment. In other words, the domestic demand never absorbed all of the available supply and consequently foreign borrowers could rely with a fair degree of assurance upon the possibility of securing additional accommodation in London. Contrast now the experience of the foreigner with the American market. We began a few years ago with not a little blare of trumpets to make very considerable foreign investments. Satisfactory investments, no doubt, but at the same time, we congratulated ourselves upon the assistance that we were rendering the rest of the world. Then the domestic demand for funds increased and we, so to speak, closed up shop.

Consider the case of a bank which had taken the accounts of numbers of business concerns, granted them credit for a season or two, and then one fine day informed them that the bank had found a better use for its money. No well managed bank does that sort of thing. It assumes that it has a certain

responsibility to its customers and so long as they remain in satisfactory financial condition, they can rely upon the bank. The foreigner, at least so far as recent experience may be taken as a basis for judgment, cannot rely upon the United States as a source of a fairly stable supply of additional funds or even consider himself secure against endeavors to withdraw rather suddenly some of the funds already invested.

Our money market for short-time accommodation has also appeared as a more disturbing factor in the international situation than at any former period. We have had many stock market booms in this country but the recent boom is the first since the United States has become a creditor country. In the old days when we were a debtor country, an 8% to 10% or 12% rate for call loans would have frightened the foreign investor and far from attracting additional funds, it would rather have tended to bring about the withdrawal of some of the accommodation already extended. But since our market has become exceedingly strong as a creditor market, the advance in money rates no longer has that effect but rather tends to force up rates in other countries through its attractive force.

If from time to time in the future the New York money market is to show an increasing demand for funds measured in billions of dollars which continues to expand in spite of 12% money, then the question will doubtless present itself whether it might not be to the advantage of the rest of the world to establish its systems of currency upon some other basis than that occupied by the United States. In the light of recent experience, however, it is perhaps reasonable to presume that operations in the security markets are altogether unlikely to be similarly disturbing again for many years to come, if ever. I think we may anticipate that the Federal Reserve System in the future will take more drastic action and at an earlier date in order to check a speculative movement of the type which we have recently experienced, and I think we may also be fairly confident that the precedent conditions favorable to an extreme advance in security quotations and the attitude of the public at large will hardly be so favorable, at all events during the lifetime of most of us here present. I am therefore disposed to think that the disturbing influence on the working of the gold standard arising out of the character of

our stock market activities will not reappear and may be regarded as being out of the way for the future. But, I repeat, other factors requiring careful management in the near future remain, and for that reason I believe it will be a long time before we approach anything like the simplicity of functioning of the gold standard of the pre-war period. Too much must not be expected from the gold standard in a period marked by very wide departures, actual or prospective, from an equilibrium of payments between the nations.

I now turn to another aspect of the gold standard problem, that which has to do with secular price trends. I accept the view that it is highly probable that the supply of gold currently produced from the mines will not be adequate under existing methods of monetary use to support a sufficient amount of credit to maintain the present level of prices throughout the world. The question therefore presents itself whether it is possible under the gold standard to meet a situation of declining production in gold without a serious decline in prices over a somewhat indefinite period of, let us say, from fifteen to thirty years. It may be noted first that some changes have occurred in the mechanical relationship between gold and the volume of the circulating medium. It happens that in some directions, recent changes economize the use of gold and in other directions, changes have apparently the opposite effect. The net result, therefore, seems rather indeterminate. A very great economy has been secured through the practical elimination throughout the world of gold coin as currency and there will probably be no reversion to this quite needless use of gold unless there should be a very large increase in the output of gold from the mines threatening undesirable upward movements of prices. On the other hand, there is now a more general establishment of definite legal reserve ratios. In this country, we have for generations had reserve ratios and by the establishment of the Federal Reserve System and subsequent changes in the Reserve Act, the gold legally required as a basis for a given volume of credit has been materially reduced. In the case of many other countries, however, which did not have any gold reserve requirements in the pre-war period, these requirements have been established as, for example, in the case of

France where a 35% gold reserve has been set up against both the notes and deposit liability of the Bank of France.

The establishment of legal reserve ratios has an effect that is not fully measured by the ratios themselves since they inevitably lead the banks of issue to desire to acquire more than the legal minimum. Working on the basis of a 35% legal requirement, a bank of issue naturally will desire to have 40% to 50% in gold in order to take care of increasing credit demands as well as to meet contingencies. This universalization of gold reserve ratios appears to me to be the most serious obstacle in the way of meeting a situation that will arise in the event of declining gold production. What is needed to meet that situation is an attitude of mind on the part of the public together with legal authority which will give elasticity to or remove rigidity from the relationship between gold stocks on the one hand, and the supply of credit and currency on the other. It cannot be too strongly emphasized that there is no particular ratio between gold on the one hand and credit and currency on the other that is required to support and to give strength to the credit structure. Attention has been called to, some alarm expressed at, the declining ratio between gold and total bank deposits in the United States, a ratio that has declined in recent years from 7% or 8% to between 5% and 6%. This decline is a matter of absolutely no real consequence. What is important in the case of our banks is the character and nature of the other 95% of assets backing the deposits. Whether out of the 100% of assets, 7% is gold and 93% other assets, or 95% other assets and only 5% gold, is a matter that has no practical significance. What is important in the case of gold is that there should be a sufficient amount available in each country to meet any requirements for use that may conceivably arise in particular requirements of gold for export. Looked at from this point of view, the amount of gold that the different countries need greatly varies, but the amount does not depend upon the magnitude of the outstanding volume of credit. The United States, for example, needs comparatively little gold because from its creditor position it would be able to check a gold outflow by very moderate advances in rates which would be followed by the usual repercussion upon security movements and trade. On the other

hand, a country like Brazil needs a relatively large gold reserve or gold exchange because it is a country which is mainly agricultural. Its exports are largely made up of coffee, a product subject to considerable variation from year to year on account of differences in the crop and the course of prices. Moreover, the country is heavily a debtor country. Therefore, no possible increase in discount rates and other lending rates in Brazil could be relied upon to check an outflow of gold due either to withdrawals of foreign capital or to a shrinkage in the value of exports. But the amount of gold that might be required cannot be directly related to the volume of credit and currency that might be outstanding in the country.

In the event of a shrinkage of gold production and clear evidence of a deficiency of the supply of credit owing to inadequate reserves under existing legal requirements, the appropriate remedy would be a very gradual reduction in the reserves of the central banks of issue throughout the world. This reduction to be effective should be limited to the banks of issue and not extended to any reserve balances required of other banks. A reduction in the reserve required of the member banks in the United States, for example, would not accomplish the desired result because it is certain that the member banks would immediately utilize to the full any reduction without any reference whatever to the course of prices. But a gradual decline in the reserve ratio of the Federal Reserve Banks from the present level of 70% to, let us say, 20% would be quite within the limits of safety if it were made gradually and with a view to the prevention of credit contraction or such a limitation on the normal increase in the supply of credit as would force a downward movement of prices over the years. We need not be slaves to the supply of gold, and the reason is the very simple one that the character and strength of the credit and currency of a country is in no fundamental way determined, much less measured, by the amount of gold which is held.

DISCUSSION: CREDIT REGULATION THROUGH THE FEDERAL RESERVE SYSTEM¹

MR. ROBERT B. WARREN (economist with Case, Pomeroy and Company, New York; formerly with the Federal Reserve Bank): While I am sure that most of us in our private capacities are agreed that during the last six weeks either we or the market made a number of regrettable mistakes, I think we may also agree, looking at it in an entirely Pickwickian manner—in which manner I appear before you this afternoon—that it was one of the most beautiful panics that the world has ever seen. (Laughter.) It was beautiful because it was so free from extraneous and confusing circumstances. It was not caused by a catastrophic decline in commodity prices. It was not caused by the sudden eruption of war and alarms without. It was not caused by a direct inability to obtain credit. It was not complicated by any unusual development of a politically adverse character in the legislative or administrative bodies of government, as was the case in 1907. It was almost free from all those things that we usually associate with panics. All that happened was that securities were at one level and then all of a sudden, to quote from a recent popular book, we suddenly found that there were “new levels of security prices.”

The paper of Professor Edie seemed to me to be particularly apt and timely at this moment. Undoubtedly one of the functions and one of the leading desires of a central bank is to avoid these economic spasms that from time to time convulse all countries and particularly frequently the United States. But while it is the aim or one of the aims of a central bank to prevent such crises, there are certain very profound limitations upon the action which it is able to take, particularly in the early stages.

You will remember that at the entrance to the Treasury in ancient Rome there was the statue of Janus, a deity with two faces. He looked both inward and outward. And that is very much the position of a central bank. As Mrs. Malaprop remarked of Cerberus, “It must be three gentlemen at once.” (Laughter.) A central bank is first of all of course charged with the administration of its own money market, but so long as it is a member of the society of gold standard nations it cannot entirely divorce itself from certain international responsibilities. Very frequently there is a conflict at that

¹ An abstract of the discussion following the addresses by Messrs. Seager, Burgess, Edie and Sprague, at the Afternoon Session.

point. The policy which might be most desirable from the point of view of the domestic money market may be extremely undesirable from the point of view of the international money market. That paradox certainly was characteristic of the last two-year period. All through the period, from the beginning of 1928, when the brakes were applied very moderately, even a moderate application of brakes was felt sensibly in countries remote from our own.

Then, too, because we are a member of an international society it is possible to a certain extent for the central banks of other countries to thwart the operation of the central bank of one country and that again I think was characteristic to a limited extent of the past few months.

In the application of the brakes it is of course always the duty of the central bank to do as little as it can to impede the progress of legitimate business, so-called, while it is restraining the progress of speculation. In other words, even though it is recognized at a given period that it is desirable to begin to apply brakes, the amount of pressure that should be put on those brakes is an extremely difficult matter to determine, owing to the absence of satisfactory criteria. At what point has a wave of commendable optimism turned into a wave of unjustifiable speculation? So far as I know, there is no way of telling that until afterwards and then it is pretty late.

So far as the expansion of bank credit was concerned the Reserve banks did apply very effective brakes, even as early as the latter part of 1927. The principal criteria of credit expansion in this country show that there was no perceptible expansion of Reserve bank credit through the member banks between September of 1927 and September of 1929. For the United States, a country which is habituated to something like a five per cent expansion per annum in its credit, a good deal of restraint is implied merely by the curtailment of the expansion of credit for two years. A good deal of pressure was put on the brakes. That it was not sufficient was proved only by the event, and after all it is the consequence and not the theory that counts.

In this connection, however, it is to be observed that as regards the supply of money for speculation, the central bank of the United States occupies a peculiar position. For more than a hundred years before there was any Federal Reserve System we had an organized money market, a call market centering about the Stock Exchange, which developed an extraordinary degree of efficiency in performing many of the functions of a central bank. It could not, it is true, issue currency. It could not expand credit. It could, however, mobilize capital and place it at the disposal of speculators, and it could exercise a tremendous drawing power upon foreign countries,

pulling their gold, and in that way expanding credit. When we organized the Reserve system, the act virtually ignored the existence of this ancient régime, and in no way impaired its capacity to function in rivalry, should conflict of interest ever arise between the Reserve system and the speculative community. In early 1928, as soon as the Reserve banks undertook effectively to suspend the expansion of credit, the Stock Exchange reverted to type and resumed its extraordinary efficiency as a mobilizer of capital and as an attracter of gold, in that way very largely circumventing the work of the Reserve banks. It could and did function in effective opposition.

This fact, it seems to me, illustrates the vital point which Professor Edie brought out in his paper, namely, that the legal separation which exists between the Reserve system and the speculative market is one of the great weaknesses of our whole position.

Legally, a literal interpretation of the Federal Reserve Act would bar the use of Federal Reserve credit in the only call money market that we have; yet, as we have seen in the last few weeks, very large amounts of Federal Reserve credit may be introduced into the Stock Exchange in emergencies, apparently solely for medicinal purposes.

Professor Edie laid his finger upon the crux of this situation. We have had a panic. We have had a panic which if it had not been so beautifully free from other conflicting elements—if one item of really bad news had appeared on one of those delirious days—might have resulted in a money panic as well as a security panic. In some way or other we must work out a better *modus vivendi* between the credit system of the country and the Stock Exchange. I cannot formulate a perfectly satisfactory partnership between the Federal Reserve system and the Stock Exchange. I do not believe that we can ask the Reserve system to guarantee us even against security panics as long as there is a complete separation. We cannot ask the Reserve system to guarantee us against mistakes in judgment or to guarantee the Stock Exchange as a body against ill-timed operations. But until there is some recognition that there is and must be a definite relation of mutual responsibility between the biggest single part of our money market and the central bank which is charged with responsibility over our whole money market—a mutual responsibility, not a one-sided responsibility—we can never be free from the peril of such episodes as occurred between the middle of September and the middle of November.

MR. RUFUS S. TUCKER (American Founders Corporation): Both Professor Sprague and Dr. Burgess expressed some doubt as to the simplicity of the working of Federal Reserve or other reserve banks in their attempts to control price fluctuations and other undesirable

phenomena. It seemed to be their opinion that in normal times the classic theory was approximately correct and workable but in extraordinary times it seemed very unlikely that the central banks could have much effect on market conditions by acting in the classical manner.

It was said at one time by an editor of the London *Economist* that a six per cent bank rate would drag the gold right out of the ground and it seemed to be a true statement of the situation in England between 1840 and 1920. But it is equally true that an eight or ten per cent bank rate is more apt to shove the gold right back into the ground because when such a rate as that prevails people who have gold will hoard it and it will no longer have its normal effect on the business activities of the community.

The fact that this was not appreciated until recent years is due I think to the fact that the countries that had adequately developed banking systems which were in a position to act in the classical manner as regards their reserves did not go through any severe war until the Great War. During the Civil War the United States had a notoriously bad banking system and the fact that no adequate measures of restraint could be taken by the banks at that time was not a serious objection to the classical theory. The War of 1870 between France and Germany lasted such a short time as far as the actual fighting was concerned that the exchange rate of the franc did not depart more than two per cent from gold parity and consequently the classical theory of control of credit by central banks was not seriously affected by that episode. It was not until the Great War, when most of the countries that were presumably on a gold standard drifted far from it, that the inadequacy of shifting the discount rate at the central bank became fully apparent.

Even in ordinary times, as Dr. Burgess suggested, there is some doubt as to the exact way in which the methods of control work out. A very recent episode bears on this point. The New York Reserve Bank raised its discount rate on August 9. According to the classical theory that action should have been followed eventually by a decrease in the exchange rates of the leading European currencies. No such decrease occurred. For three weeks at least the stock market continued to rise in this country and even in one or two European countries and then leading stocks began to waver in price; especially in Europe they began to go down; but there was no effect on the exchange rates.

The Bank of England raised its discount rate on September 26. It would be natural for a hasty student of the situation to assume that that was responsible for the increase in the exchange rate of the pound sterling and of the other leading European currencies

that took place at about that time. But the actual fact is that those exchanges started to go up, every one of them, five days before the Bank of England raised its rate. If there was any connection between these two phenomena it seems evident that the increase in the Bank of England rate must have been the result rather than the cause of the rise in the pound sterling exchange quotation.

It seems to me that the real cause of that movement of exchanges and therefore indirectly of the fall in stock prices that took place in this country in October was the Hatry failure in London. Hatry was arrested on September 20. On the next day the rates of all the leading European exchanges showed a perceptible rise. They had been below par, as was normal at this season of the year, but they started an upward march that continued without interruption until October 24, at which time they were considerably above par, despite the ordinary seasonal trend.

October 24 was also the day of the first bad break in Wall Street, the first panic day. It seems obvious from the quotations of the exchanges that there were large transfers being made of funds from this market to the leading European markets as a result of the Hatry failure, and that these transfers continued until they could no longer be made profitably.

Of course it is impossible to say whether these transfers were made by European speculators who had to protect their own position in their home markets, or whether these European speculators reasoned that if the situation in London was so bad the situation in New York must be worse, and therefore withdrew. It makes little difference what their motive was. There is no doubt that there were vast sums of European money invested in one way or another in this country. Some of these sums were invested in stocks, some in call loans, and some presumably in acceptances.

During the period between September 20 and October 24, at first while stock prices were declining, call loans as reported weekly by the Federal Reserve Bank continued to increase. That seems contrary to the suggestion I have just made, but if we analyze these figures more closely there is a possible interpretation. The weekly figures published by the Federal Reserve Bank do not include loans made for speculative purposes unless they are made through the intermediation of banks that report to the Federal Reserve System. The monthly compilations made by the Stock Exchange do include some of those sums, in other words, money that is loaned directly by foreigners to brokers in this country. There was a period when stock prices were falling and it was natural therefore to presume that brokers' loans would fall, but the weekly report of brokers' loans showed an upward movement while the monthly report showed

a downward movement. It seems to me that this contradiction must have been caused by the fact that many foreigners who had previously made loans to brokers or other loans on collateral on their own account directly, without the intermediation of New York banks, either withdrew those loans entirely or renewed them only through the agency of a New York bank in order to get the added protection. It happened by pure accident, I believe, that there were large amounts available in the hands of newly organized investment trusts that had just floated their securities and had not yet had time to invest the proceeds. Consequently the volume of money available for call loans did not decline immediately when the foreigners began to withdraw their funds, but only after two or three weeks.

The money that was obtained by foreigners from the sale of acceptances or that was saved by them by refusal to buy acceptances that they would otherwise have bought, was replaced by the increased purchases of acceptances by the Federal Reserve Bank.

That is of course just a tentative explanation which it is impossible to prove by figures. But to the extent that the foreigners who had money invested here in actual stocks sold their stocks, naturally, stocks fell in value. That fall continued for the first three or four days of October and was followed by a reaction upward, but it had gone so far that confidence was severely shaken and apparently everybody tried to get out on the bulge, with the natural result that the prices turned down again on October 10 and continued down.

It seems to me then that we can blame the Hatry episode in London as the occasion of this recent fall in our stock market. I say "occasion", not "cause", because of course an episode like that could not have had such a serious result unless the structure had already been erected to a dangerous height and stood just ready to topple over at a slight touch.

There is much difference of opinion as to the responsibility for the building of the structure to such a height, and of course some tend to blame the Federal Reserve Board for not taking more strenuous action. I think that we should not be too hard on the Federal Reserve Board or on anybody else in authority, for the reason that people with what was considered to be sound and thorough economic training differed so widely as to what the actual situation was and whether there was any inflation.

In the spring of 1928, at a meeting of the American Statistical Association in New York, someone pointed out that there were good indications, based on past history and indices that had proved valuable as forecasters in times past, that a serious reaction in the stock market might occur in any single month from May, 1928 to Novem-

ber, 1929 inclusive, and there was practically as good reason for picking one month as there was for picking another. This much may be said to the credit of the science of economic forecasting: that the break actually occurred with five weeks to spare.

As long, however, as economists have to set a time period of eighteen months within which something must happen, it is impossible for anybody in a position of authority to give an entirely satisfactory reason for any action he might take to curb this anticipated event. Moreover, even if action were taken, it frequently happens that there are some people who cannot be controlled by such action.

I have already mentioned my belief that the sudden withdrawal of foreign money was partly responsible for the fall in prices. I cannot conceive of any way in which the Federal Reserve Board could have kept that foreign money out without encouraging even more speculation on the part of the domestic speculators. Raising the discount rate is usually assumed to be a means of attracting foreign money. Lowering the discount rate in order to drive away the foreign money would make it easier for domestic speculators to operate.

On the whole, with the development of international investment and the increased knowledge acquired by the speculators and investors of one country concerning conditions and methods in other countries, severe fluctuations in stock values and stock quotations will gradually be ironed out. There will be enough funds controlled by intelligent and well-informed people to shift from market to market, as one or another becomes more attractive. I look forward to much less erratic movement and wild speculation in the next ten years than we have had in the past ten, but it will be many times ten years before everybody will learn how to speculate in moderation and to avoid being sadly burned when guesses go wrong.

MR. ROBERT D. KENT: As an introduction to the paper which follows, I would state that the conclusions brought out in it are based upon an active banking experience of fifty years. As a text I quote a short extract from the address of Vice-President Hazlewood of the First National Bank of Chicago on retiring from the presidency of the American Bankers' Association at its recent convention. He said: "The Federal Reserve System is for our use in emergencies to carry us over peak periods, to influence the general credit situation through its open market operations, and to be the custodian of the country's gold supply upon which all credit is based. The Federal Reserve System does not operate for the purpose of adding permanently to the funds which we dispense to our customers, nor to enable us to make an additional profit through re-

discounting at a better rate, nor to make it possible to take care of customers who desire to purchase or hold securities after the loanable funds of our banks have been exhausted by commercial or agricultural loans."

Mr. Hazlewood correctly states the purposes of the Federal Reserve System, but I cannot agree with him when he states that it does not operate for the purpose of adding permanently to the funds which we dispense to our customers nor of enabling us to make an additional profit through rediscounting at a better rate. It should not, but it does actually so operate.

At its inception, so far as I recall it, there was no intention that the system should issue currency at wholesale rates to banks for the latter to retail to their customers at higher rates. Old-fashioned and conservative bankers condemn such a policy, but bankers by the thousands seek to make the additional profit mentioned and condemned by Mr. Hazlewood. So far has this practice gone that when the credit strain of the past few months grew more acute the banks very largely found themselves with lines of accommodation so high with the Federal Reserve banks and with such a limited supply of eligible paper on hand that they could not readily apply for further assistance. In consequence they were compelled to decline to grant credit that under normal conditions would gladly have been extended.

It has been uniformly the policy of the Bank of England to maintain its rate somewhat above that of the street or open market. This policy results in the automatic operation of the law of supply and demand through the banks of the nation, a surer index of business requirements than the judgment of the majority of a body of eight or ten men.

The mistaken policy of the Federal Reserve System indicated above has been a large factor in bringing about the overextended use of credit through which we have been passing for the last two or three years and which has resulted in losses of hundreds of millions of dollars to our people. If the reaction is not soon stopped, it will produce much more serious results.

James B. Forgan, the eminent banker, said in an address: "In the long run commerce suffers more from periods of overabundance of money than from those of scarcity. The origin of each recurring period of tight money can be traced to preceding periods of easy money. Whenever money becomes so overabundant that bankers in order to keep it earning something have to force it out at abnormally low rates of interest, the foundations are laid for a period of stringency in the not far distant future, for then speculation is encouraged, prices are inflated, and all sorts of securities are floated."

In view of the acute situation which has recently existed it is felt that the Federal Reserve Bank acted wisely in lowering the rate to 5 and then to $4\frac{1}{2}$ per cent. A sudden change to a higher rate than the current market rate for money is not advocated but the policy which has been pursued should be reversed gradually and the expansion power of the Federal Reserve Banks reserved for special and emergency uses as indicated by Mr. Hazlewood.

MR. ROYAL MEEKER: Mr. Edie made a remark that I should like very much to hear elaborated. He said he had the material to develop a discussion of the methods available to the Federal Reserve System for control or prevention of panics. Anyone who has given much thought to the subject would agree to the principle laid down by Mr. Edie and advocated by Mr. Sprague, I believe, that the primary function of a central bank is the prevention of panics and not the philanthropic job of comforting the widows and binding up the wounds of those who suffer when the panic has broken.

Granted all that, it seems to me that there is large room for disagreement on the part of Mr. Sprague and Mr. Edie. How can the Federal Reserve System possibly control production expansion so as to prevent panics if the gold supply, the very basis of our currency and banking system, subjects our price level to a continual decline such as we suffered from the sixties down to 1897?

I should like to have Mr. Edie tell us if he agrees with Mr. Sprague who, as I understood him, said it does not make any difference whether we have 1 per cent, 70 per cent, or $1/10$ or $1/100$ of 1 per cent of gold reserve against our bank liabilities; just so long as we have something, a grain of gold, somewhere in the country, the gold standard is safe and sound and we can go on making progress onward and upward as in the last two or three years.

I do not believe it. Either we must discard the gold standard or we must devise new ways of economizing the use of gold if present indications of the declining gold supply are fulfilled.

MR. NORMAN LOMBARD (executive vice-president of The Stable Money Association): I was about to suggest that Dr. Edie develop that part of his paper which apparently limitations of time prevented his giving. I am particularly interested in knowing how the Federal Reserve System can prevent a rise in Stock Exchange prices through monetary control without exerting a repressive influence upon industry and bringing about a period of unemployment.

MR. SPRAGUE: There was a slight implication by Professor Meeker which I did not intend to give in my remarks about the appropriate

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amount of gold. That had no reference whatever to either crises or panics. I merely pointed out that, gradually, over a period of time, if the gold reserve at existing ratios should prove to be insufficient, or if the gold supply should prove insufficient to maintain an adequate supply of credit to support something like the present level of prices, we could gradually work down to a lower gold reserve. Even then we might perhaps have the same aggregate amount of gold, but it would form a lower percentage of the total outstanding liabilities. I cannot conceive a situation in which there could be a withdrawal of gold from the United States amounting to as much as one, two, or three billion dollars; under existing financial and economic conditions any considerable withdrawal from the United States could be readily checked by moderate advances in discount rates. I simply insist that for each country the quantity of gold needed to support its credit structure is not to be measured by a universal reserve ratio of 35, 40 or some other percentage.

MR. EDIE: With Dr. Sprague's views on the gold reserve ratio I would heartily agree. I see no reason for adhering to the present relatively high reserve ratios. They could be scaled down to less than half what they are at the present time without imperiling the effective operation of the gold standard. After talking with people in central banking circles during the last two years in London, Paris, Berlin, Amsterdam, and elsewhere, I am so impressed by the tenacity with which the central bankers of Europe adhere to gold, put it on a pedestal and worship it almost as a fetish, that I am strongly of the opinion that we adhere too strictly to reserve ratios. I think there is great danger that the minds of central European bankers are wedded too much to gold as an automatic monetary standard.

With regard to the other questions about the weapons for prevention of crises, I would very briefly mention them without discussing them.

First, I think that the central banks must have very strict regard for those periods when either the business community or the speculating community seems to be so greedy for funds that there tends to be an increase of loans or investments of member banks at faster than a normal rate. At such a time the central banks should become extremely cautious in feeding out central bank funds to serve as a reserve basis for that secondary expansion in member bank credit. Specifically, I give it as my opinion that there was too much generosity and liberality on the part of our central banks in early 1928 in feeding funds out into the market which were greedily absorbed and later gave rise to a great many problems.

Weapon Number 2 would be moral suasion. That may sound like

a rather empty weapon in the United States but I am convinced that it is a most powerful weapon in foreign countries and can become much more of a weapon in the United States than it has been thus far.

But failing moral suasion there remains the rate of discount. The technique for making a rate of discount effective is different when you are dealing with speculative markets from what it should be when you are dealing with production, business and trade. When you are dealing with production, business and trade a gradually rising rate of interest is retarding and restrictive, but it is not particularly retarding or restrictive in speculative expansion. The only kind of rate change that is decidedly effective in dealing with a speculative market is likely to be a sharp and drastic rate change, decisively enforcing consistent moral suasion.

I would say, therefore, that there are three weapons for prevention of crises: (1) regard for preventing expansion of credit; (2) the use of moral suasion; (3) a due regard for the different techniques of rate increases when you are trying to deal with a speculative situation and when you are trying to deal with a business situation.

MR. BURGESS: Professor Edie has made a very real contribution to this question, for it is true that the writers of the Federal Reserve Act did not contemplate the situation that has arisen in the recent past. There is nothing in the Federal Reserve Act which indicates that they contemplated the necessity for dealing with a huge speculative expansion. The words describing the use of the discount rate and the use of Federal Reserve credit are all of a contrary nature: the discount rate, according to the Act, "shall be fixed with a view of accommodating commerce and business." You can interpret that broadly and say that business is best accommodated when you adopt firm money policies in the face of too great speculative enthusiasm, but that is carrying the phrase a bit beyond the contemplation of the writers of the Act. It is like the development of constitutional practice in any country. Practice has to go beyond the view of the people who originally wrote the document. In this case it seems to me a logical extension.

One might also add that the general public in this country has not recognized dealing with a huge speculative use of credit as within the functions of the Reserve Bank. I think a clearer recognition of that is desirable as we go forward—a recognition that there is no water-tight wall between the use of credit in business and the use of credit in speculation. A bank of issue has to deal with the whole picture, not part of it.

That brings us to the particular question whether by more vigorous methods the Reserve system could have checked the recent de-

velopment in time. It is entirely conceivable that more vigorous action taken more promptly might have produced the result. Whether it was actually possible, no one knows. Perhaps, in the light of the experience of the past two years, more vigorous action may become possible on future occasions.

It is also a very grave question whether more vigorous action would have been successful. The fact is that the stock market did not break until business had shown pretty clear signs of recession, until some of the fundamental bases for optimism were beginning to crumble beneath the feet of those who were promoting the speculation. Whether Federal Reserve action would have produced the result earlier, I rather doubt. I know that when the discount rate of the Federal Reserve Bank of New York was raised in July, 1928, for the third time within a period of three or four months, it was clearly in the minds of the people dealing with the situation that that rate change would probably be decisive and that the decks could be cleared so that autumn trade could then go forward on a better basis. It was not decisive. Whether a still further increase would have been decisive nobody can say.

We have been experimenting in the field of central banking. This business of running a central bank where everybody knows that the rate increase is dictated by prudence rather than by necessity is a brand new experiment. In the old days when a central bank raised its rate the public knew it was because credit would actually be deficient. On the recent occasion when the Federal Reserve System raised its rate with a seventy per cent gold reserve, the public was not convinced of the gravity of the situation.

MR. WILLIAM J. SEWARD (manager, Overlea Office, Union Trust Company of Maryland): I should like to ask Mr. Burgess a question regarding the Federal Reserve System.

Had all of the banks in this country been members of the system, would it have helped in this present situation? The reason I ask that question is because I am a small banker from Baltimore and at one time we were members of the system. We withdrew not because we were opposed, or antagonistic, but because we found that it cost us between two and three per cent of our capital and surplus to maintain our membership.

MR. BURGESS: If you look at the question technically, considering the working of supply and demand in the money markets, it would not have made very much difference, because this situation was one that primarily involved the principal centers. The debit figures indicate the extent to which that was true. The debits, which are

the same as the old clearings, outside of the principal centers showed relatively little increase over this entire period, but the figures for the principal centers show a tremendous increase in the velocity of turnover of bank deposits.

Respecting the control of the Reserve banks over the price or the quantity of credit, it would not have made very much difference whether all the banks were in the system or not. The system now has within its membership three-quarters of the banking resources of the country. That is enough to take care of the element of technical control.

The point where it might have made a difference is in that great unknown field of public psychology. The business man gets his opinions from the banker. Opinions spread throughout the whole country in ways that we know not of. Whether it would have made any difference if more of the banks of the country had been in touch with the Federal Reserve System, I do not know. I rather doubt if it would have changed the picture very much.

MR. E. L. THOMAS: Since the crash in the stock market the Federal Reserve System and other agencies have been endeavoring to introduce a new spirit of buoyancy and hopefulness into the situation. The rates of money have been lowered. The market has been flooded with money. It seems to me that there is an attempt being made to create a situation wherein stocks will again be purchased and people will have an optimistic attitude toward the whole financial structure. Is there not a danger of creating a new situation in which buyers of stocks and securities may be hurt, and lose in a crash again?

MR. BURGESS: That is again a problem in human psychology. I shall take the liberty of reading a quotation from the *London Times* under date of May 14, 1866, which describes the situation at that time:

"About once in ten years the British public finds itself worth several hundred millions less than it had supposed. Its estimate of its wealth had gradually risen to a climax too extravagant to last long, and then toppled over. At every such disappointment people make the reflection that they are at least the wiser for it, that they will not be taken in a second time or perhaps that they will avail themselves of the next general infatuation and back out in time. Nevertheless, the next fit comes on them like the rest and they go through all the stages of the disease with pathological accuracy. Some of course are wiser, not better; for they have suffered persecution, but not learned mercy. The multitude are fleeced and plucked as they were ten years ago, and twenty years ago, and thirty years ago, and forty years ago. We may even go on and say fifty years ago

and as it happens a hundred and fifty years ago, minus a year or two, when the South Sea Bubble burst.

"How is it then that people don't learn by experience? The answer is to be found in the individuality and peculiar circumstances of these successive delusions. Each one has such distinct characteristics that it cannot be identified with its predecessors and can safely disclaim all acquaintance with them. Every delusion is monstrous when it is found out and till then a marvelous discovery."

MR. CHARLES W. BIRTWELL (secretary of The Stable Money Association) : I should like to ask whether a great many transactions that might be called "extra-banking transactions" are not after all truly invested with a public interest, and whether they should not be brought within the scope of the supervision of state or federal banking authorities. Certain wise men a few months ago told their brokers to sell their stocks and loaned the proceeds on call. Is that not banking? The banking laws of some states are now regulating, right down to the last nickel, loans under \$300 to poor people, so as to protect these poor people. Should not call money lent to brokers to be taken back by selling people out, even without notice, be brought in some way within the purview of public banking?

MR. BURGESS: I am afraid that is too big a question to go into at this late hour. I quite agree with the speaker that it is one of the problems we have to think about.

PART III
BUSINESS, SPECULATION AND MONEY

THE RESPONSIBILITY FOR CREDIT INFLATION

GEORGE E. ROBERTS

Vice-President of the National City Bank of New York

The Course of Credit Inflation

MR. FRANK VANDERLIP, returning from a trip over Europe in 1922, wrote a book of reflections upon the state of demoralization which he had witnessed. He gave one chapter to Inflation, and summed it up in a few sentences. He said:

Of all the visitations of evil upon human society as now organized, those that follow in the train of unlimited inflation of the currency have the most profound effect. It brings on the people of a nation through every level of society an endless chain of misery and suffering.

The inflation which made such a profound impression upon Mr. Vanderlip was that of the lawful paper currencies, to the point of extinction or nearly so throughout the greater part of Europe. The conditions which existed at that time never have been paralleled.

The public generally has a good understanding of how excessive issues of a paper currency which is not on a gold basis will result in a loss of purchasing power, but it does not quite so clearly understand that there may be inflation and depreciation in the case of currencies which are on a gold basis, and even in the case of gold itself. It is not always understood that rising prices and money depreciation are phases of the same situation—opposite ends of the same teeter board.

This country is usually considered to have remained on the gold basis throughout the war and years following, although we maintained an embargo on gold exports for some time. However, we gained in gold holdings during the war and were practically on a gold basis; but so much credit was issued throughout the world, in one form or another, to serve as purchasing power, that it depreciated the value of gold itself, causing a world-wide rise of prices.

By way of illustration, take our experience during the war and the years immediately following:

We had a practically unlimited demand for labor and materials for industry, backed by an unlimited amount of credit, over against a limited supply of labor and materials. The first effect of such a situation is that whatever slack had existed in the industries is taken up; and when you have every available worker employed and every machine running that is about all you can do to increase production for the time being. You have your organization working up to its capacity, and if you attempt to drive it harder you create a competitive situation in which an individual employer can increase his own output only by getting labor or materials away from other employers, which is done by bidding up wages and prices. That is what we did during the war and we came out with a wage and price level more than twice as high as the pre-war level.

That is inflation, and it results wherever the volume of purchasing power, be it gold or paper currency or bank credit, is issued in excess of the amount which a country can absorb without rising prices.

In this country we use paper currency only for comparatively small transactions. The great bulk of our business is done by the deposit and check system. Bank deposits and checks constitute the principal circulating currency. There are two classes of deposits. One class arises in the regular course of business, by the sale of commodities and services. The volume of this class of deposits is comparatively uniform because it is directly related to the regular production and trade of the country. Another class of deposits is created by loans.

When a bank makes a loan to a business man he takes credit for it in his account, which means an increase in the bank's deposits. The borrower will check against it, but his checks will be deposited in other banks; hence, a general increase of bank loans will cause a general increase of bank deposits and a general increase in the amount of purchasing power in circulation.

The expansion of credit in this manner is limited by the reserve requirements. Our banking laws require that every bank shall keep certain cash reserves against its deposits. Our

banking system is based upon gold, and in the last analysis the capacity of our banks to expand their credits depends upon the holdings of gold. The reserves are consolidated in the Reserve banks, so that the reserve of each member bank consists mainly of a credit at a Reserve bank. That credit may be replenished or supplemented by borrowing at the Reserve bank, but of course lending by a Reserve bank increases the burden on its own reserves.

Gold Imports the Basis of Inflation

During the war, when the allied powers were making enormous purchases in this country, they were sending great sums of gold in payment, and this gold entering the bank reserves made possible the expansion of bank credit which occurred at that time. That period of expansion continued for two years after the war was over and culminated in 1920, when the entire system was expanded practically to the limit, including the Reserve banks. The situation was strained, with interest rates at a panic level, until finally it was eased by a great deflation movement, which by lowering all prices reduced the amount of credit required in use.

There followed a period of stagnation, but soon another gold movement into the country began. Importations of gold come first to the member banks and are turned over to the Reserve banks as Reserve deposits. I want you to note how rapidly the lending power of the member banks increased as the result of these importations. The Governor of the Federal Reserve Board in an address has stated that, on an average, for \$100 of deposits carried by a member bank the Reserve bank receives \$7.50. That is approximately 13 to 1, and means that one additional dollar of reserve will support \$13 of credit or \$7,500,000 of new gold will support \$100,000,000 of new credits.

In the first several years of this influx a considerable part of the new supplies was used to pay off member bank indebtedness at the Reserve banks, but in the five years from June 30, 1922 to June 30, 1927, with an increase of \$800,000,000 in our gold stock, total loans and investments of member banks increased by about \$8,000,000,000, or approximately 10 to 1.

This however, was not the total increase of bank credit, for

the non-member banks participated in the expansion. The total loans and investments of all banks in the country, member and non-member, increased in that period by an amount equal to $17\frac{1}{2}$ times the additions of gold.

These figures give the measure of the influence of these imports upon our credit situation and suggest the influence of this credit expansion upon our business life.

I want to point out here that this gold did not come because we wanted it or planned for it. It came as the result of a combination of conditions, for none of which had we any responsibility. The trade of the world was disorganized, the industries of Europe were disorganized, and Europe was not able to maintain her accustomed volume of exports. On the other hand, those countries were under the necessity of making great purchases in the United States, the trade balance was heavily against them, they had sold their marketable securities during the war, and they had practically no means of payment except in their stocks of gold. Furthermore, conditions were so unsettled in Europe that everybody who had anything that could be conveyed to America was wanting to establish reserves in this country. In short, the gold came as the result of abnormal social, political and economic conditions in Europe. The world had lost its equilibrium and spilled its gold into our lap.

This gold influx was the basis of the great expansion of credit that followed. It furnished the bank reserves without which the expansion of credit could not have occurred. It was coming continuously from 1920 to 1927. Here is the fundamental cause of credit inflation.

No Inflation of Commodity Prices

The bankers and economists of Europe confidently predicted credit inflation and price inflation in the United States. Some of them actually advocated as a policy the dumping of gold in the United States for the purpose of causing a general rise of commodity prices here which, they argued, would relieve the industrial depression in Europe and in the end send back all of the gold thus employed and more with it.

They were disappointed that a rise of commodity prices did not take place in the United States, as should have been the

case according to accepted economic theory. As a matter of fact it was fortunate for our country that this credit inflation did not get into the commodity markets. The difference between the state of general business today and in 1920 is due to the fact that it did not get into the commodity market. But why did it not?

The explanation lies in the fact that our merchants and industrialists had suffered such heavy losses by the fall of commodity prices in 1920-21 that they had no inclination to increase their stocks or inventories. It takes buying, usually in anticipation of future wants or future values, to put up prices. It takes the speculative spirit, and there has been no spirit of speculation among American business men, in the commodity field, since 1920. From what they have known of new economies in production and increasing capacity for production in this country, and considering that commodity prices have been well above the level of 1913, they have had no faith in any theory of rising commodity prices. They would have none of it, and as a matter of fact commodity prices have tended downward throughout the years since 1920. And for that reason business is upon a more secure basis today.

Credit Goes to the Security Markets

How then were these new supplies of credit to be used? It is an axiom that cheap money is bound to find a demand somewhere. It found one for considerable amounts in real estate operations, but the greatest demand did not get fully under way until the latter part of 1924 and beginning of 1925. This was the speculative demand in the stock market. Bonds and stocks had been low in price, interest rates on short loans were low, and it was possible to buy good bonds and stocks and carry them on borrowed money at less than the returns they were paying.

For example: throughout the four years 1918 to 1921 New York Central stock was selling around \$65 a share. It was paying annual dividends of \$5 per share, and at the market price the yield was nearly 8 per cent. After 1920, capital was accumulating, gold was pouring in and enlarging the basis of credit. By the middle of 1922 time loans on mixed Stock Exchange collateral were down to $4\frac{1}{2}$ per cent and call loans

much of the time lower. The average renewal rate on call loans for the whole year 1924 was only a shade above 3 per cent.

The public is quick to take advantage of such an opportunity as that to borrow money on a 3 or 4 per cent basis and carry New York Central stock on a 7 or 8 per cent basis. That gave the first impetus to the stock market. And when a rising market gets well under way it travels on its own momentum. It is able of itself to attract support; and of course, such movements almost invariably go too far. More people do things because other people are doing them than because they know the reasons, and that is progressively true of a bull market. The market had occasional setbacks in 1925 and 1926, but on the whole gained confidence on the recoveries, until in the fall of 1927 something happened.

Gold Exports and Reserve Policy

As a result of a combination of factors, such as improvement in European conditions, the return of a number of countries to the gold basis and a large aggregate of foreign loans floated in this market, there began the largest gold export movement since the war. Before it ceased, by the middle of 1928, we had suffered a net loss of \$500,000,000 in the standard metal.

Up to that time the incoming supplies of gold had enabled the member banks to supply increasing amounts of credit without resorting to the Reserve banks for aid, but with gold flowing outward they were under the necessity of resorting to the Reserve banks in order to avoid the contraction of credit. That \$500,000,000 came out of member bank reserves, and if that loss had been allowed to have its natural effect, the entire credit situation would have been involved. The Reserve banks met the situation by releasing credit, at the same time giving notice that they had no intention of supplying credit to finance any further demands of the stock market.

This declaration was made repeatedly, the discount rate was raised in January, 1928, again in May and again in July of that year and other steps were taken to tighten the credit situation and to prevent the absorption of Reserve credit by the market. The member banks were cautioned against allowing Reserve credit to be used in the market, and so far as practic-

able they coöperated. The figures for brokers' loans show that in the first half of October, 1929, the loans of this class held by the member banks of New York City were no greater than two years before.

I want to make it clear that after the outward gold movement began the banks consistently pursued a restrictive policy toward loans in the market. Indeed they had no alternative. They did not have the reserves upon which to base continued expansion.

The statement made by the member banks of New York, as of October 5, 1927, of loans to brokers and dealers for their own account and on behalf of out-of-town banks and "others", shows the total to have been \$3,206,000,000, of which the share of the New York member banks was \$1,175,000,000, or 36.6 per cent. On October 2, 1929, the total of these loans was \$6,804,000,000 of which the share of the New York banks in round numbers was \$1,071,000,000, or more than \$100,000,000 less than in 1927, and their percentage of the total was 15 against 36 in 1927. I offer these figures as conclusive proof that the New York City banks were not responsible for the growth of brokers' loans from October, 1927 to 1929.

Furthermore, the total of borrowings by the member banks of New York City at the Reserve Bank of New York as shown by the statement of October 23, 1929 was only \$41,000,000. That is to say, just before the heavy liquidation began, the member banks of New York City, with aggregate loans and investments of 7½ billions, were using only \$41,000,000 of Reserve credit for all purposes.

The Influence of High Interest Rates

The change in the situation effected by the loss of gold, while influencing the attitude of the banks, did not command the attention it deserved from the speculative public. The market was under too much momentum to take it seriously. The market was strong in the opinion that it could get what money it needed by paying higher interest rates, and proceeded to demonstrate that theory with considerable success. Of course, it is known that higher interest rates will attract money. They have a saying in London that ten per cent will draw gold out of the ground.

The manner in which money or credit responds to high rates is simply an illustration of the ordinary workings of the law of supply and demand. If any commodity is in short supply, so that there is not enough to meet all demands, the price naturally rises until a part of the demand is eliminated, and an equilibrium is established on the new basis. The people who are willing and able to pay the price get what they want and others go without.

When the market began to pay interest rates which attracted attention it began to get funds from new sources. For a number of years the New York banks have rendered a service to valued patrons by lending funds for them in the call market. The aggregate of such loans is reported by the banks weekly to the Federal Reserve Bank of New York, divided into three groups, "Loans for own account," "Loans for out-of-town banks," and "Loans for others." By the first statement in October, 1927, the loans for "others," which item includes individuals and corporations, resident in New York or elsewhere, aggregated \$922,000,000. At the corresponding date of 1929, these loans for "others" aggregated \$3,907,000,000, having more than quadrupled. The loans for out-of-town banks increased about fifty per cent. The two classes increased by about \$3,500,000,000.

There is elasticity in all uses of credit, particularly over limited periods. Nearly every locality can practice economy in the use of credit for a time, and with money lending in Wall Street at seven and eight per cent and even higher rates there was a strong inducement to practice it. Savings, profits and other free funds, which normally would be going into permanent investments, were attracted to the stock market for investment or loan. In the government statistical year ended June 30, 1929, for the first time in twenty years, the aggregate of savings deposits in the United States showed a decrease. Every part of the country was undergoing the pressure of rising interest rates. The market had found a way to go around the banking system to the original source of funds. This is the outstanding feature of this period.

The high rates for money reached beyond this country. They affected all the money markets of the world. American capital has been an important factor in the recovery of Europe

since the war. The first effect of rising interest rates was to stop the flotation of foreign loans in this market and the withdrawal of American capital which was temporarily employed abroad. Foreign bonds held in this country declined in price, as did all bonds, including United States Governments, and this induced purchases to some extent by residents of the countries where the bonds were issued. This amounted to a transfer of foreign capital to this country. As rates continued to rise and more was heard of profits being made in the American market, funds began to come from all parts of the world. Gold began to flow to this country, again, until up to October 1, 1929, we had recovered approximately one-half of all we had lost in the big outward movement of 1928-29. The effects in Europe were soon apparent. In the first five months of this year Germany lost gold to the amount of \$250,000,000, approximately thirty-six per cent of its gold reserves—a very grave matter to a country needing capital as Germany does. The Central Bank of Germany raised its discount rate to 7½ per cent, and not trusting to this rate alone to restrict the demands on it, enforced an arbitrary rationing of credit, including in many instances a reduction of loans.

The state of the money market in Berlin in May can be judged by the fact that the government of the republic in that month issued a 5-15 year loan for an amount equivalent to \$75,000,000 with 7 per cent coupon rate and the offering price 99. As an attraction to big taxpayers, this loan was made exempt from the property tax, the income tax and estate taxes if in the estate of the original holder. Common interest rates for well secured collateral loans were ten to twelve per cent. In June, to further assist the government and to relieve the pressure, a syndicate of Berlin banks negotiated from a syndicate of New York banks a loan of \$50,000,000.

By this time practically all countries were taking steps of some kind to prevent a further loss of gold from their reserves. The discount rates of fifteen of the central banks of Europe had been raised since the beginning of 1929. Our good neighbor, Canada, thought it necessary to place an embargo on gold exports, although this meant for the time being an abandonment of the gold standard. The Montreal exchange rate on New York, ordinarily about ½ of one per cent, rose as high as

2½ per cent. Argentina, after losing \$65,000,000 of gold to New York since January 1, concluded that self-defense was the first law of nature and followed the example of Canada by placing an embargo on gold exports, or at least upon shipments to the United States.

The Bank of England lost the equivalent of \$150,000,000 of gold between the middle of last June and October 1. Not all of these exports came to the United States, and this is true also of the German exports. The movement to the United States was the dominating influence everywhere, but it caused a general readjustment of European holdings.

The Bank of England discount rate had been raised from 4½ to 5½ per cent in February, and a further increase had been anticipated for some time, when it was raised on September 26 to 6½, which is almost a panic rate in London. As showing something of the tenor of comment in London at the time, I will read an extract from an editorial in the *London Statist*, a well-known and reputable financial journal, under the date September 28, 1929:

Our own difficulties arose directly out of the abnormal conditions obtaining in the United States. British funds flowed to New York in order to profit by the high rates obtainable in the call loan market. America ceased to lend to the Continent, and the credit accommodation previously supplied by America to such countries as Germany was, in part at least, found in London. Moreover, foreign balances held in London were withdrawn in order to be more remuneratively employed in New York and in Berlin.

The Bank rightly considered itself to be protecting the interests of Europe against those of the United States in resisting for as long as was feasible the pressure on sterling exchange. In addition, it was, by its stand, fighting for the interests of domestic trade and industry whose recovery must to some extent be impeded by high money rates and by lack of stability in credit conditions.

The effect of an advance of a central bank rate in a tight money market is to raise the general level of market rates, because at such a time any increase in the supply of credit must come from the central institution. The London situation was disturbed at the time by the failure of an issuing house of some importance, and the general situation as regards British and European funds in New York was such as to cause the action of the Bank to have the maximum effect. The advance of the

rate was immediately followed by a depreciation of New York exchange, which showed that funds were being transferred in important amounts away from New York. London was selling and withdrawing loans and the Continent was doing likewise. In this withdrawal of foreign funds is to be found the immediate cause of the break in the securities market which came in October. The market had been absorbing credit at a higher rate than the whole world could supply it, and of course this pace could not be maintained indefinitely.

I have sketched the conditions out of which developed the inevitable expansion of bank credit on the basis of gold imports and the successful manner in which the stock market supplied itself with funds after the banks had been forced to adopt a restrictive policy. This is the story in outline. There are some phases of the situation upon which I would like to comment further, and particularly the criticism that has been directed at Reserve policies.

Federal Reserve Policy

It is surprising that so many people should have forgotten the fundamental purpose for which the Reserve system was established.

The old banking system was lamentably, disgracefully, weak in every period of strain. In every period of prosperity the great body of the banks, influenced by competitive conditions, would become extended to the limit, and when such a period ended in a crisis, as it usually did, there were no reserve resources anywhere strong enough to deal with the situation. In every crisis the banks, instead of acting as a system, standing together, would pull apart, and the whole credit situation would collapse. In 1907 the banks from the Atlantic to the Pacific suspended cash payments, and virtually shut up shop until they could liquidate sufficiently to begin again.

The panic of 1907 prompted the establishment of the Reserve system. The purpose was to consolidate the scattered banking reserves of the country in a few strong institutions, to be known as Reserve banks, whose chief function, as the name implies, was to be the management of the reserves with a view to protecting, supporting and stabilizing the entire banking and business situation. The use which these banks could make

of the funds in their care was clearly and sharply restricted. They were to be used only for short loans to aid in financing the seasonal turnover of trade, and not at all for financing investments. The reason for this apparent discrimination is that credit wanted for moving the crops or for financing spring or fall trade is of limited amount and soon released, whereas there is no end to the amount of credit which may be tied up in financing stock and bonds, nor to the length of time it may be held. The Reserve Act was drawn with the intent of setting apart a fund devoted to Reserve purposes, and so safeguarded that it never could be drawn upon and possibly exhausted by a great speculative movement.

Furthermore, the Reserve system itself has had some experience with a boom period—an experience carrying a very valuable lesson. The system had scarcely been established when the war broke out, and about two and one-half years later this country entered the war. The Reserve banks were authorized to lend on United States bonds and notes and they quickly became the principal agency of the Treasury in financing its needs. As a result they came out of the war loaded to the guards with rediscounts, secured by Liberty bonds. In 1920 the country experienced a credit crisis, followed by a great deflation of prices, and many of you will remember the storm of criticism that fell upon the Reserve banks for their failure in that crisis to render the aid that was expected of them.

But, how could they assist anybody? They were up to their necks in the situation themselves! The strength of a Reserve bank is in its reserves, and these institutions had no surplus reserves. They were in the same fix as the other banks which were wanting help from them. They had nothing to put into the situation, but were under the necessity of collecting in their outstanding credits before they could grant new ones.

In view of this experience what possible defense would have been available to the Reserve authorities if they had allowed Reserve credit to become an important factor in that increase of brokers' loans from \$3,000,000,000 to \$8,500,000,000 in the last two years and a half, and how much worse might the situation have been in the last week of October, 1929, if as a fact, and to the knowledge of the public, the Reserve banks had been deep in that situation themselves?

An effort was made to provide credit for trade and industry and keep it out of other uses. The Reserve banks released credit quite freely in the fall of 1928, but unquestionably the stock market received indirect assistance thereby. The money market cannot be divided into watertight compartments, and Reserve credit cannot be released for any purpose without to some extent affecting all divisions of the money market. Its release for one purpose may set credit free for a wholly different purpose, and, in the last analysis, if the Reserve banks intend to control their own reserves they must control them absolutely and business of all kinds must adjust itself to the conditions.

Reserves of the United States and Great Britain ~

In this connection, let me add that a mistaken idea has been widely held to the effect that the reserves of our Reserve banks have been extraordinarily strong in comparison with the banking reserves of other banks of issue. A hasty inference has been drawn from the fact that the reserve percentages published weekly frequently have been around 75 per cent. These percentages relate only to the direct liabilities of the Reserve banks, and it should be considered that these serve as practically the only reserves of all the banks. Before the Reserve banks were established, the National banks of New York City were required each to carry a cash reserve of 25 per cent. Now the lawful requirement is that they shall have reserve credit of 13 per cent in the Reserve banks.

Much has been said also of the government's reserve against gold certificates, but if we take the figures for that reserve together with those for the reserves of the banking system, and reckon them against all of the credit currency and bank deposits of the country, the reserve percentage over the last two years has been not 75 per cent, but between 6 and 7 per cent.

The United States and Great Britain are the two countries in which the use of bank credit is most highly developed, and the percentage of gold reserves to all currency and bank liabilities is lower in these countries than in any other country.

It is impossible to make an exact comparison of the reserves of the two countries, because the most complete banking statistics for this country are based upon reports as of June 30 of

each year and comparable figures for Great Britain can be had only as of December 31 of each year. However, this does not prevent a fairly correct comparison. About one year ago I made up a set of figures which showed that on June 30, 1928, the United States percentage was 6.46 and that on December 31, 1927, the Bank of England percentage was 6.19. I have recently made another calculation which shows that on June 30, 1929, the United States percentage was 6.79, while on December 31, 1928 the Bank of England percentage was 5.55.

It must be considered that Great Britain is a comparatively small country, that branch banking prevails, with about 75 per cent of the banking business of the country handled by five banking institutions. It hardly can be said that the gold resources of our Reserve banks are relatively stronger than those of the Bank of England.

A Hesitating Policy

I think there can be no serious disagreement with the proposition that the Reserve banks are right in the general policy of protecting their reserves and preventing their resources from being drawn away into employments outside the scope of the Reserve Act.

Another class of criticism has been directed at the Reserve authorities, by parties who in the main have been their stout defenders. I refer to comments to the effect that they might have obtained effective control of the money market during and following the great export gold movement of 1927-28 if they had moved more decisively. The point is made that the system went farther than was judicious in releasing credit in the fall of 1927, to offset the gold exports, and that in raising the discount rate $\frac{1}{2}$ per cent at a time in January, May and June, 1928, it allowed the market to become accustomed to each change before the next occurred, thus losing a decisive effect. This now has become a case of judgment long after the fact. It is quite probable that if it were all to be done over in the light of today the action of the authorities might be different.

It is only fair also to take into account all of the conditions existing in the first half of 1927 and the first half of 1928. It was a period of declining business activity and of increasing unemployment. Much anxiety existed as to how serious the

depression might become. These conditions could hardly fail to have some weight as the authorities confronted the question of raising interest rates. It may be presumed that there was a balancing of considerations—on the one hand the disadvantage of higher rates to business and on the other the need for a repressive influence upon the rising tide of speculation.

The Lesson

It is a fair conclusion that if the Reserve authorities expect to control credit inflation they must act decisively in the early stages of its development, before it obtains headway enough to be indifferent to moderate increases in interest rates. Moreover, they must have the coöperation not only of the banks but of the public, for we have seen that when a great inflationary movement gets so well under way that it will outbid regular business with its offers for money, vast sums will be transferred from the control of the banks directly to the market.

The greatest lesson of all from this crisis is that banking control over credit is effective only within narrow limits. All of the laws and rules that may be provided for the regulation of banks will avail nothing if the public which holds the final control over bank deposits elects to exercise that control itself. Here again, as so often in endeavoring to deal with the problems of a democratic society, we find that order and progress are dependent upon understanding and coöperation among the people themselves.

THE PRESENT BUSINESS SITUATION

HON. HERBERT H. LEHMAN

Lieutenant Governor of the State of New York

I am not going to attempt to explain or analyze the recent very substantial selling of securities and the attendant price decline through which we have just passed. We are still too near the event itself to permit of a detached, intelligent viewing of the situation in proper perspective. I think we shall do better, for the time being, to look to the future rather than to the past, and I intend therefore simply to give a few impressions and thoughts bearing on the industrial and mercantile prospects of the country.

The decline in securities has been so sharp that there has become implanted in many minds the thought that there may be a resultant extended period of substantial business and industrial depression. I said at the dinner of the Credit Men's Association, nearly two weeks ago, that I did not believe this would be the case, assuming, of course, that collectively we use common sense and courage—I still retain that optimism. That business will be affected to some extent by the huge security losses is probably a fact, but if the situation is properly and intelligently and constructively handled, I do not believe that any possible trade recession will assume serious proportions or be of more than short duration. There are too many constructive and hopeful factors in the situation to justify any pessimistic outlook at this time.

I have emphasized, however, and again wish to emphasize the need of constructive and intelligent individual and group action. Both the severity and duration of any possible trade recession will, I believe, be directly in proportion to the constructive leadership and constructive business sense shown by the bankers, merchants and manufacturers of this country during the next few months. The present situation fortunately differs fundamentally from others that have occurred at least within the memory of the present generation. Periods of depression in industry ordinarily come as a result of (a) inflation

in merchandise inventories or in commodity prices, or (b) a serious money stringency. The present situation is obviously not the result of either factor. Certainly, at the time when serious decline of security values commenced, merchandise inventories throughout the country were of reasonable size; and it is equally true that commodity prices had no element of inflation, and, if anything, were too low. It is equally obvious that at the present time there not only is no money stringency but the deposit banks generally are as liquid and strong in cash resources as at any time for many years past, and anyone entitled to credit may obtain it at reasonable cost.

I am confident, therefore, that the industrial and financial structure of the country is fundamentally sound and if mistakes are avoided and constructive action advanced we need have no substantial fear of the future. "Speculation has come out of stocks but there is no speculation that needs to come out of business." We cannot afford, however, to proceed along haphazard lines, or to depend too greatly on the efforts of others, or of governmental authority. Prosperity does not come just for the wishing. It does not come through dicta. It does not come through consultation and conference alone, valuable as these undoubtedly are. It must be the result of community effort, intelligently applied and directed. Government can lead, inspire and coördinate; effective action, however, in a situation of this kind must come alike from manufacturer and worker, farmer and consumer, merchant and banker.

I shall address myself first to the consumer, because, after all, consumption is the keystone on which trade and industry are erected. One cannot, of course, disguise or deny the fact that the buying power of a considerable number of people has been curtailed by security losses, and yet in relation to the population of this country that number is small. The publicity which these losses have received, however, and the unreasoning fear of future developments, may have a psychological effect on a far wider circle than those who have been directly affected by security losses and accordingly, if the situation is not viewed properly, might conceivably affect their willingness to continue their normal purchases at this time. This is bad psychology, bad business and bad morals. One neither expects nor wants anyone to buy unnecessarily or beyond his or

her means, but certainly those who have the financial ability legitimately to satisfy their requirements and desires both for necessities and luxuries should not hold back purchases or fail to carry out commitments at this time. To do so can only result in increased and unnecessary unemployment and adversely affect their own personal financial interests and the interests of the whole country. Under no circumstances do I advocate spending merely for the sake of spending. That would be wrong and wasteful, but it should be the fashion and practice of those who can afford to buy and pay to continue to exercise their purchasing power for merchandise where merchandise can be used to advantage.

Manufacturers and merchants, while exercising proper caution in making fresh commitments, should, regardless of effort, maintain interest in new styles and fresh merchandise. "Style merchandise" today is no longer a narrow term; it applies to automobiles, kitchenware and refrigerators as well as to women's wear. The consumer's interest must be maintained by intelligent sales promotion, attractive sales display and adequate advertising.

Obviously, trade and industry are based on credit. As I have said before, the financial situation of the country is so easy that every merchant and manufacturer of responsibility and standing will be able to obtain, at reasonable rates, such credit as may be necessary for the conduct of his business. On this score there can be no question, in my opinion. That, of course, will take care of the sound manufacturer and merchant. A large portion, however, of our distributing of merchandise has of recent years become increasingly dependent on credit not furnished directly by the banks. It is therefore important that the credit lines given to the small dealer, to the distributor and to the consumer himself, by merchant and manufacturer, be not curtailed. Discretion and common sense must be used by the manufacturer and merchant in the granting of credits just the same as in the purchasing of raw materials and the creating of inventories, and yet, in my opinion, a courageous, farsighted, liberal policy of credits by manufacturers and merchants should be maintained, so that consumption may be retained on a satisfactory level and mass production at low cost assured and accelerated.

Every effort should be made to maintain and develop the export trade of this country. A few months ago I was frankly pessimistic over the outlook for the maintenance of America's export trade. I felt that many reasons made it unlikely of realization. The present situation, however, obviously helps, not handicaps, the export movement because the buying power and disposition of European countries has been, or will be, increased. In the first place, because of the lowered interest rates and other reasons there have been large withdrawals of capital by foreign countries, making that money again available for use abroad. Easy money should again make available funds from this country for investment abroad, particularly in the way of financing public improvements, etc. Intensive production here, with possible lowered prices in some lines of merchandise, will again provide attractive opportunities to foreign buyers. Probably means must be found to finance, temporarily at least, certain foreign purchases, but the maintenance, and if possible the further development, of our export trade is so important that banker and manufacturer must co-operate in this respect and we must secure outlets for our merchandise through the granting of legitimate credits in the same degree and manner that foreign countries have found expedient for the past several decades. Steps of this character will not only be valuable now but have constructive usefulness in the general larger scheme of our export trade in the years to come.

Of paramount importance, in my opinion, will be an understanding attitude of capital toward labor. It is important that employers in all lines, except where overproduction is marked, should take no steps toward the reduction of working forces, and it is of equal importance that no situation that may arise be used as an excuse for the reducing of wages or the lowering of working conditions. Nothing could unsettle general conditions more than a hurried and wholesale discharge of workers, or the attempt to take advantage of a situation to reduce wage scales. The buying power of the country would obviously immediately be adversely affected and there would develop a sense of resentment and unrest which would take a very long time to cure. We have suffered from many economic fallacies in the past few years, and have too eagerly

substituted new theories and experiments for economic principles which had stood the test over many generations. One theory, however, comparatively new because it goes back only a dozen or fifteen years, has proven itself by experience, test and common sense. I refer to the economic gain to the country through fair wages, reasonable working conditions, and attendant increased productivity. The country can never willingly take a step backward in this regard.

I believe that much can and should be done by the federal and state governments as well as by municipalities to speed up their construction programs. I do not favor at any time except in specific emergency (which is not confronting us now) building by governmental divisions just for the sake of building. This is wasteful, unsound economically, and must in time inevitably react adversely on the community. There are, however, in every government unit, federal or otherwise, a great many construction projects which are recognized as absolutely necessary or highly desirable, and which in the ordinary course would be carried on over a fixed period of time. I refer for example to many projects in this state which are clearly shown to be essential for efficient and orderly government, or for the improvement of the health, happiness and prosperity of the people. These projects, so far as resources and provision of law will permit, should be speeded up, so that benefit may come to the country from increased employment and increased purchase of materials.

I am certain that the State of New York will not only maintain but increase, so far as it may, its construction program during the coming year, laying particular emphasis on the building and maintenance of roads, the construction of hospitals and prisons, and similarly greatly needed and serviceable undertakings. These will be made possible through increased budgetary appropriations out of current funds, as, of course, no bond issue is, or can be, made available, without a referendum to the people of the state.

Finally, much constructive work by common carriers and other public service agencies, as well as by private enterprise, has undoubtedly been postponed or delayed in the recent past, because of high interest rates, and the difficulty of securing economical financing. The substantial easing of interest rates

again makes governmental, municipal, railroad and other public utility financing practicable and attractive and will, I am confident, lead to the satisfying of construction requirements delayed at least in part for some time past.

I believe that the recent orgy of speculation in this country has been of real detriment to world trade. The lure of huge profits in the stock market and the abnormally high interest rates which have ruled in this country for the past two or three years have drawn into our security markets money that would otherwise have been used for the development of industry here and abroad.

With the coming again of low money rates, easy credits, and the flow of money back into trade and industry, I think that we may be on the eve of a world trade revival of really great proportions. From such a revival we shall undoubtedly profit in a substantial degree. It may not come within the next six months or even a year, but I am by no means certain that, in a large way and in terms of world industry and world trade, the recent decline in the security markets may not prove to be of actual great and constructive benefit to this country and to the world at large.

The situation is so sound that, granting we have proper leadership in the future as we have had in the past, providing all elements of our industrial and trade lines coöperate, trade and industry require no stimulation. All that they require is sound, constructive effort on the part of all.

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SPECULATIVE ASPECTS OF RECENT ECONOMIC DEVELOPMENTS

FRANZ SCHNEIDER, JR.

Financial Editor, *The New York Sun*

AS a topic for discussion, speculation seems as dangerous as politics or religion. Most current discussions of the subject are notable for the heat generated rather than the light shed. And this despite the fact that speculation is an inherent element of the system of private property and modern business, and that it has existed ever since primitive man produced more than his needs of the day required. The functions and value of speculation are well recognized by economists. The professional speculator helps to shoulder the risks of business and helps to provide a continuous market in which investors can buy and sell and on which banks can rely for determination of values and maintenance of liquidity of collateral. Speaking broadly, much of the progress of the world has been based on speculative activity. Most of us would agree that this continent would never have been discovered on an investment basis. The penetration of the Alleghenies and the settling of the Middle West was, after all, a distinctly speculative enterprise. Speculation may be excessive or insufficient; its judgment of future values may be mistaken or correct; it may be indulged in by persons qualified or unqualified. The institution is capable of abuse; but its place in our economic system is secure.

In the present instance, severe controversy has raged for several years over the speculative implications of the bull market in stocks. To some this market has represented nothing but the product of frantic and unintelligent speculation. To others it has seemed but a reflection of existing prosperity. To still others it has appeared but the forerunner of much bigger and stronger markets. Again, the latest phase of decline is regarded by some critics as the inevitable collapse after a period of exceptional speculative mania. To others it represents nothing but the success at long last of a two-year effort

by the Federal Reserve Board to undermine confidence in values. When it comes to placing blame for what has happened, the positions taken reflect every variety of bias. Certainly the bitter controversy of the past few years has not tended to promote clear thinking or judicious conclusions; and it would be premature to assume that the recent break in prices has settled the question of values any more permanently than did the antecedent rise.

Under the circumstances it is pertinent to review briefly the developments of the past few years and to consider just what we mean by speculation in relation to them. The broad upswing in stock prices that has just culminated may be considered to have started in 1927. Industry then was reacting, more particularly in the second half of the year, after culmination of the prosperity of 1926. In the autumn the Federal Reserve authorities reduced the system's discount rates to a $3\frac{1}{2}$ per cent basis, injected credit into the market on a large scale and helped to initiate a gold export movement that eventually carried half a billion dollars' worth of the metal abroad. With money rates at low levels stock prices and brokers' loans rose despite the decline in industrial activity.

An upturn in industry made its appearance early in 1928 and this movement continued strongly until last summer. Before its end, this upswing brought new high records in business activity and a remarkable increase in profits. During the first six months of 1929, for example, the net profits of 300 industrial companies, as tabulated by the Standard Statistics Company, increased 33.6 per cent over those for the first six months of 1928. The corresponding gain for 39 railroad companies was 36.5 per cent; and that for 28 utilities was 13 per cent. But to go back to the close of 1927, Federal Reserve credit having then reached new high levels for the period since the post-war deflation, the authorities decided to reverse their policy. During the first half of 1928 discount rates were marked up rather hesitatingly to five per cent. As money grew dearer the bond market became depressed and ended a four-year bull movement; but rising business kept stocks forging ahead. In the late summer of 1928 Federal Reserve policy again was modified and an admittedly excessive amount of money was put into the market through the acceptance route.

By the end of 1928 the volume of Federal Reserve credit had risen still higher; and the first half of 1929 witnessed a struggle between the New York Reserve Bank, which wished to raise its discount rate, and the Reserve Board, which refused to permit the advance, which clung to an ineffective "warning" policy and which insisted on "direct action" against member banks to control the distribution of credit. The Board apparently thought it could keep business on the upgrade, starve out the call money market and put down the stock market at one and the same time. The attempt failed, and high call rates attracted money from all over the world. However, deflation of Federal Reserve credit through heavy sales of acceptances during the first five months finally brought a general liquidating movement in May that sharply affected the price of farm products. Thereupon the authorities prepared again to enter the acceptance market on the buying side and by August 8 reached a compromise whereby the New York bank was allowed to raise its rate to six per cent but at the same time lowered its buying rate for bills. Meanwhile the bond market had remained depressed under the influence of high money rates while stocks continued to be sustained by reports of record-breaking earnings.

Without attempting to decide whether or not the general liquidating movement of May affected the business situation, it may be pointed out that the industrial upswing, which had run strongly for a year and a half, reached its peak by midyear. The steel industry then operated at full capacity, which is wholly unusual for the summer season, railroad car loadings set new high records and the automobile industry finished the greatest half-year in history. As autumn approached the pace slackened; by early September operations in the steel industry had fallen to 90 per cent. By early October the rate was down to 85 per cent. Late in November it was about 70 per cent.

As for stock prices, the advance achieved between midyear 1928 and midyear 1929 was not so remarkable in view of the big increase in profits that had occurred. On the average, industrial stocks rose about 30 per cent; rails about 15 per cent. The corresponding increases in industrial and railroad earnings were, we have seen, 33 and 36 per cent. However, at the very culmination of the business upswing a violent bull market

in utilities made its appearance. Between June first and the end of September a number of leading utility shares doubled in price. This movement represented strong exploitation of the market possibilities of the holding-company situation. Its occurrence seriously weakened the position of the whole market.

In addition, another disturbing development was coming to a head. This was the issue of new securities on a mounting scale. Back in 1922 and 1923 flotations amounted to about five billions a year. By 1926 the total had risen to about seven and a half billions. In 1927 it jumped to approximately ten billions. During 1928 it held the same level. In this connection it is interesting to recall that it was in 1927 that brokers' loans began their rapid increase. In any event, new issues for the first half of 1929 broke all previous records, amounting to $6\frac{1}{4}$ billions. June issues aggregated \$790,000,000, those for July \$940,000,000 and those for August \$868,000,000. In September the extraordinary total of \$1,615,000,000 was reached. In this month the decline in stocks began; nevertheless brokers' loans rose, according to the Stock Exchange tabulation, by \$670,000,000. Even in October, with the market decline in full swing, new offerings amounted to \$877,000,000. Furthermore, the totals were swollen by the boom in promotion of investment trusts and trading companies; and by heavy issues of new stock to shareholders in existing corporations through issue of rights. For the ten months, new capital issues amounted to \$10,575,000,000. Of this total, domestic common stocks accounted for \$4,694,000,000. Financing by investment trusts and trading and holding companies aggregated \$2,440,000,000 of which \$1,351,000,000 was offered in July, August and September. For September alone the total was \$641,000,000.¹

The stock market staggered under the impact of this new financing. The decline during September was orderly and the volume of trading was moderate; but the benefit secured from liquidation of outstanding securities was more than offset as heavy subscriptions on new issues came due. In October the decline quickened but the market continued to step down in orderly fashion until the turnover on the Stock Exchange

¹ These statistics on new issues are taken from the *Commercial and Financial Chronicle*.

reached six or seven million shares a day. It must be remembered that the existing ticker system was designed to handle 3,000,000-share markets. By not printing volume it was made to suffice for about 4,000,000 shares. But beyond that the ticker began to fall hopelessly behind the market. As volume increased further the supplementary telephonic quotation system from the floor also passed out of operation and during the crisis reports on executions of orders lagged far behind, in some cases by days or even weeks. Meanwhile the trading public was left in the dark as reporting facilities, instead of expanding flexibly to accomodate the press of business, broke down and so aggravated the selling. The only effective orders were those placed "at the market"; and the massing of these at a time when intelligent buying was impossible, brought perpendicular declines. The Exchange no longer was providing a continuous market; buyers and sellers no longer were being brought together in rational fashion. It was this situation, and the attendant destruction of public confidence, that the banking group organized itself to mitigate. Brokers properly insisted that margins be kept good and the sharpness of the decline, even with fifty per cent margins, forced additional selling. Finally a prodigious 16,000,000-share session brought the greatest confusion and disclosed the inadequacy not only of the tickers but of all the brokerage and banking machinery for handling such a volume of Stock Exchange business. In the old days we had money panics due to the inflexibility of the country's banking system. Creation of the Federal Reserve System remedied that situation. In the present instance we have had a stock market panic because of the inflexibility of trading and reporting facilities. This statement does not mean that a thoroughgoing readjustment of speculative positions was not on the cards; such a readjustment plainly was due. But it need not have been so severe but for the breakdown in reporting facilities. An impressive demonstration was given of the proposition that a real market cannot be maintained unless people know the prices at which things are selling. Fortunately, in the end, natural forces, aided by the steadying influence of the banking group, restored an equilibrium as weak holders were eliminated and low prices attracted strong investment buying.

Reviewing the record briefly, we find that we are concerned with an eighteen months' upswing in business that terminated in new high records for activity, coupled with what now seems clearly to have been an overissue of new securities. The summer boom in utilities was unfortunate both in timing and magnitude; and the reaction in stocks was exaggerated into panic proportions by inadequacy of reporting facilities. Meanwhile during most of the period there was dissension within the Federal Reserve System, the Board being unwilling to allow the regional banks to follow orthodox rate policies and insisting on policies of its own that proved ineffective. The whole business machine attained what, for the moment, was probably too fast a tempo.

Under the circumstances it serves no useful purpose to heap all the blame on the margin trader or to attribute our troubles merely to speculation—unless that term is expanded to include all errors of judgment committed by consumers, industrialists and bankers. Speculation plainly was present but it was undoubtedly the result and not the cause of the fluctuations in values. In fact, the margin trader has been pretty roughly used and has some cause for complaint. He was not responsible for the uncertainties of Federal Reserve policy and only partly for the overissue of securities; but he paid the penalty for both. He was operating on margins that were considered very conservative; but in his hour of trial he was very nearly deprived of a market in which to sell.

However, such sympathy for him should not obscure the fact that many persons speculated who were not qualified to assume the risk-bearing function and that many committed themselves in amounts disproportionate to their other resources. Professor Emery, in one of his clear expositions of the subject,¹ divided speculators into three groups. In the first he placed the professionals with large capital. To honest speculators of this type he gave full approval. In the second class he placed men of some means and judgment who, while regularly concerned with some other business or profession, are inclined to use a small part of their means in attempts to make a good turn in the market. Of this he approved pro-

¹ Emery, Henry C., "Speculation," in *Every-day Ethics*, Yale University Press, New Haven, 1910.

vided the man stayed within his means and did not let his speculation interfere with performance of his full duty in his major calling. I think we will all agree that this proviso has been violated rather freely during the past year. In the third class he placed men who have neither the character nor the means to take chances. Here he included the great group of small gamblers who feverishly try to get rich quick. Speculation by members of this third class, he pointed out, is destructive of standards of work and saps the very spirit of industry on which economic welfare depends.

Regrettable as the losses suffered by this class are, it is unwise to exaggerate the part it played in bringing on the recent collapse. To do so would be to distract attention from more important considerations. The country was experiencing an extraordinary prosperity, perhaps a bit too extraordinary, and it was this prosperity that was primarily responsible for the rise in stock prices. Many of last June's prices would have been justified if business had gone on increasing at the rate of the previous year and a half. Actually, the upswing halted just when it reached the stage at which danger of inflation in commodity prices began to threaten. The current recession has removed that danger and a relatively brief period of rest and recuperation should leave business in excellent condition. We still have the strongest and most promising situation in the world. Within our borders we have the greatest collection of natural resources and the greatest area of unrestricted trade in the world. Our population has been naturally selected from the most vigorous and most enterprising elements of the old world—which may account, incidentally, for its speculative tendencies. Our industries and transportation system are extremely efficient and are in wonderfully strong financial condition. Certainly their securities are at least on a par with those of any other country. And despite the events of the past two months, the country has a tremendous capital fund that is constantly replenishing itself. It also has what it lacked before the war—a flexible central banking system. Surely this is a solid foundation.

As for the immediate situation, there is little to liquidate in business, while the liquidation on the Stock Exchange and in brokers' loans has exceeded anything any reasonable critic can

have had in mind. Money already is becoming cheap; it will be unnecessary to wait for the slow liquidation of swollen inventories and the thawing of frozen credits that follows periods of business inflation. The process of industrial readjustment has been going on for several months. In any further time that may be needed for recuperation, for digestion of recently issued securities and for accumulation of fresh capital resources thought may be given to the problems disclosed by the phase of the cycle that has closed. Not the least of these is the need for permitting the Federal Reserve Banks to act promptly according to the requirements of credit conditions in their particular districts and in accordance with orthodox principles. Then too, bankers and corporation heads can consider the problem of preventing overissue of stocks, the technical indications of saturation evidently being somewhat different than in the case of bonds. The dangers involved in the market possibilities of the holding company and its subsidiaries also should receive careful attention. And the Stock Exchange clearly will wish to give renewed consideration to the serious matter of providing facilities capable of meeting, during periods of stress, the needs of the great market for securities created by extension of its ticker system throughout the country and by steady increase of the number and volume of securities listed for trading. In addition, we may hope that there will be an adequate volume of the right kind of speculation, engaged in by properly qualified persons, on both sides of the market, to the end that prices may as closely as possible reflect ever-changing values.

THE PROCEEDINGS ARE ISSUED TWICE A YEAR
THIS IS THE SECOND ISSUE FOR 1930

PROCEEDINGS
OF THE
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Volume XIV]

MAY, 1930

[Number 1

PUBLIC CONTROL OF POWER

A SERIES OF ADDRESSES AND PAPERS PRESENTED AT THE SEMI-ANNUAL
MEETING OF THE ACADEMY OF POLITICAL SCIENCE
APRIL 11, 1930

EDITED BY
PARKER THOMAS MOON

PUBLISHED BY
THE ACADEMY OF POLITICAL SCIENCE
COLUMBIA UNIVERSITY
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THE POLITICAL SCIENCE QUARTERLY

The Quarterly is published by the Academy and edited by the Faculty of Political Science of Columbia University. It is devoted to the historical, statistical and comparative study of politics, economics and public law.

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1930

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PREFACE

T semi-annual meeting on April eleventh was the first of the sessions which signalize the Academy's fiftieth year of service to an informed public opinion in America and the world. The more formal observance of the semi-centennial will take place this autumn, but the April meeting brought vividly to mind the long usefulness of the Academy and its rise from the beginnings under Professor Burgess's leadership in 1880.

Characteristically, this meeting took up perhaps the most controversial and complicated question in the field of public law and in the politics of most or many of the states, a question on which deep-seated and sometimes partisan feelings have been stirred and on which vital economic interests are at stake. It was a topic on which it was essential, but difficult, to bring about a representative and scientific discussion, with assurance that the many angles of reasonable and reasoned opinion were being given a place in the program. The task was to bring about an enlightened and forward-looking discussion in the present tense, without withholding fair representation from any important point of view which sought to contribute to the forum.

To what extent the Trustees and officers of the Academy, with the coöperation of members of the representative Program Committee, succeeded in bringing about a scholarly but provocative discussion in keeping with the Academy tradition, may best be judged from the present volume of PROCEEDINGS. At the time of the various sessions on April eleventh, the prevailing view was that the meetings were performing the service of presenting a fair cross-section of American opinion on the timely topic of "Public Control of Power". It is of course true that the public consideration of this topic must be still in its preliminary stages, and no consensus of academic or pragmatic opinion has yet been reached.

Certain it is that the daytime sessions on April eleventh brought together large and interested audiences, and more than 550 persons assembled in the evening for the semi-annual dinner.

One of the notable features of the day was the broadcasting of the afternoon addresses over WEAf and other stations affiliated with the National Broadcasting Company. This well-balanced excerpt from the day's program was thus heard and enjoyed by many thousands of listeners in distant places, who are indebted to the National Broadcasting Company for this courtesy and privilege, as is also the Academy.

The Trustees and officers of the Academy are grateful to all who took part in the program and in the open discussion, and who thus have contributed to this volume. The hope is that this compilation will prove informative and helpful to those engaged in study of the diversified phases of this pressing topic.

. The program of the three sessions was as follows :

PROGRAM

FIRST SESSION

FRIDAY, APRIL 11, 1930, 10 A. M.

NORTH BALLROOM, HOTEL ASTOR

Topic : State Regulation

ALBERT SHAW, *Presiding*

Vice President, Academy of Political Science

Editor, *American Review of Reviews*

1. *Introductory Address* by the Presiding Officer.

2. *A Quarter-Century of Regulation by State Commission.*

WM. E. MOSHER, Professor of Political Science and Managing Director, School of Citizenship and Public Affairs, Syracuse University.

3. *Have the State Commissions Fulfilled Their Intended Functions?*

HENRY C. SPURR, Editor, *Public Utilities Reports Annotated.*

4. *Fact-Finding and the Judicial Function in the Work of State Commissions.*

WM. A. PRENDERGAST, New York City.

5. *The State Abdicates, Business Governs Itself.*

JOHN H. GRAY, Professor and head of the Department of Economics, Graduate School of American University, Washington, D. C.

SECOND SESSION

FRIDAY, APRIL 11, 2:30 P. M.

NORTH BALLROOM, HOTEL ASTOR

Topic : Immediate Problems in Public ControlEDWIN R. A. SELIGMAN, *Presiding*

Professor of Political Economy, Columbia University

1. *The Breakdown of "Present Value" as the Basis of Rate Control.*

JAMES C. BONBRIGHT, Professor of Finance, Columbia University.

2. *Is Control of Operating Companies Sufficient?*

MARTIN J. INSULL, President Middle West Utilities Company.

3. *The "Contract" Method.*

RANDALL J. LE BOEUF, JR., General Counsel, Niagara-Hudson Power Corporation.

4. *The Courts and the Attraction of Capital.*

ROBERT L. HALE, Assistant Professor of Legal Economics, Columbia University.

5. *The Massachusetts Proposals for Public Control.*

LEWIS GOLDBERG, Commissioner, Massachusetts Department of Public Utilities.

6. *Discussion.*

NOEL T. DOWLING, Professor of Law, Columbia University,
on *Constitutional Aspects of Public Control.**The Regulation of Holding Companies.* (Read by title.)

LOWELL M. GREENLAW, The Pullman Company, Chicago.

THIRD SESSION

SEMI-ANNUAL DINNER MEETING

GRAND BALLROOM, HOTEL ASTOR

FRIDAY, APRIL 11, 7 P. M.

***Topic : The Future of Power Supply
and Public Control***WILLIAM L. RANSOM, *Presiding*

Acting President, Academy of Political Science.

*Is the Interest of the Public Inconsistent with the Interest of the
Utilities?*WILLIAM J. DONOVAN, Counsel of N. Y. State Commission on
the Revision of the Public Service Commissions Law.

The Courts and Commission Regulation.

MARTIN T. MANTON, Senior Circuit Judge, U. S. Circuit Court of Appeals, Second Circuit.

The Future of Power Supply and Public Control.

FLOYD L. CARLISLE, Chairman, Niagara-Hudson Power Corporation.

Revision of the Public Service Commissions Law (Subsequently contributed to this volume).

FRANKLIN D. ROOSEVELT, Governor of the State of New York.

In the development and sponsoring of this program, the Trustees and officers of the Academy had the assistance of the following representative Program Committee:

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SAM A. LEWISOHN	PAUL M. WARBURG
SAMUEL McCUNE LINDSAY	OWEN D. YOUNG

Brief comment on the special qualifications of those who took part in the program for this meeting on the power question is as follows:

DR. ALBERT SHAW, the presiding officer of the morning session, has been for many years a trustee of the Academy and

its senior vice-president. He is the editor of the *American Review of Reviews* and a keen analyst and exponent of progressive public opinion.

PROFESSOR WILLIAM E. MOSHER is professor of political science and managing director of the School of Citizenship and Public Affairs at Syracuse University. He has written extensively on questions pertaining to the electric utilities, and served as Director of Research of the Commission on the Revision of the Public Service Commissions Law of the State of New York, known as the Knight Commission.

HENRY C. SPURR is the editor of *Public Utilities Reports Annotated*, which compiles and publishes the decisions of courts and commissions on public utility questions. He is also the editor of *Public Utilities Fortnightly* and the author of a standard textbook and digest on the principles of public utility regulation, and has spoken and written extensively on utility subjects.

WILLIAM A. PRENDERGAST served nine years as Chairman of the New York Public Service Commission and seven years as Comptroller of the City of New York. He has been a conspicuous spokesman of what is generally deemed a conservative view as to the utilities.

PROFESSOR JOHN H. GRAY has been a pioneer and tireless worker in the field of utility regulation and valuation. He has been president of the American Economic Association, and is now the head of the Department of Economics of the Graduate School of the American University, Washington, D. C.

PROFESSOR E. R. A. SELIGMAN, long a trustee of the Academy, is McVickar Professor of Political Economy at Columbia University, and one of the world's leading authorities on taxation and finance.

PROFESSOR JAMES C. BONBRIGHT is professor of finance at Columbia University. By appointment of Governor Roosevelt, he served as a member of the Knight Commission, and has had much to do with the formulation and advocacy of its minority report.

MARTIN J. INSULL of Chicago has been a leader and a builder in the public utility field, president of the National Electric Light Association, and an interpreter of the company point of view and interest. He is president of the Middle West Utilities Company.

RANDALL J. LE BOEUF, JR., is now the general counsel for the Niagara Hudson Power Corporation. He has served with distinction in various professional capacities.

PROFESSOR ROBERT L. HALE holds the chair of legal economics at Columbia University and has long been a keen and scholarly writer on valuation questions. He has opened trails which many have since followed.

COMMISSIONER LEWIS GOLDBERG is a commissioner of the Massachusetts Department of Public Utilities and a vigorous champion of its policies. His comments on the Massachusetts experience afford timely contrasts and comparisons with what is taking place in New York.

PROFESSOR NOEL T. DOWLING is a professor of law in the Columbia University School of Law, and an authority in the field of public law. He sets forth in his paper the results of a special study which has been conducted at Columbia University under his direction, as to the effect of the Commerce Clause as a limitation on state control of the power industry.

LOWELL M. GREENLAW, who contributed a paper read by title, is general attorney for the Pullman Company and has done much research work pertaining to the regulation of utilities.

WILLIAM J. DONOVAN is a specialist in the relation of government to business. He has served the public in many professional capacities, most recently as counsel to the Knight Commission. His report in that capacity opened many matters for discussion. He is an alumnus of Columbia University and has served as an Alumni Trustee.

JUDGE MARTIN T. MANTON was appointed to the United States District Court by President Woodrow Wilson, who later promoted him to the Circuit Court of Appeals. He is

now the senior and presiding judge for the Second Circuit. He is an alumnus of Columbia University.

FLOYD L. CARLISLE is a banker and utility executive, "a builder of small enterprises into large", now Chairman of the Niagara Hudson Power Corporation and a forceful defender of the policies of the companies with which he is identified.

ERNEST GRUENING, who took part in the informal discussions at the morning and afternoon sessions, is well known as an outspoken liberal. He has been managing editor of the *Boston Traveler*, the *Boston Journal*, the *New York Tribune*, and the *Nation*, and is now editor of the *Portland Evening News*. In 1924 Mr. Gruening was national publicity director for the La Follette Progressive campaign.

SAMUEL FERGUSON is president of the Hartford Electric Light Company, and a thoughtful leader among utility executives. He spoke extemporaneously in the discussion at the morning session.

DR. EDWARD W. BEMIS, who contributed to the discussion at the afternoon session, was for some years a professor of political economy, but his special researches in the field of municipal monopolies led him to accept appointment as superintendent of the water department of Cleveland, Ohio, from 1901 to 1909, and as deputy commissioner of the water supply, gas and electricity in New York City, in 1919. He served for ten years on the Advisory Board of the Interstate Commerce Commission, in the valuation of railroads. He now acts as consultant for public officials on public utility matters.

This representative program produced the balanced and informative discussion which is reflected in this volume.

WILLIAM L. RANSOM
Acting President of the Academy
of Political Science.

PART I
STATE REGULATION

CONTROL OF POWER ¹

ALBERT SHAW

Editor of *The American Review of Reviews*
Vice-President of the Academy of Political Science

THE three sessions arranged for today's semi-annual meeting of the Academy of Political Science are devoted to the subject of governmental regulation and "Control of Power". This condensed phrase has reference to the scope and functions of state supervision, in respect to the kinds of public service rendered by corporations engaged in the business of supplying electrical energy for various purposes.

Let me preface some opening remarks upon this topic by reminding you that the Academy of Political Science is now in its fiftieth year. Among its members are men who have belonged to it for the full half-century. Dr. Edwin R. A. Seligman of Columbia University, who will preside at the session this afternoon, is one of the earliest members. He was a student and an associate of the Academy's first leader, Dr. Burgess. The services of Dr. Seligman as scholar and teacher at Columbia, and as publicist of wide influence, have continued with no sign of abatement and always with generous and unsparing effort for the public welfare. Dr. Samuel McCune Lindsay, whose presidency of the Academy has been continuous through almost twenty years, and whose devoted effort has had so great a part in the maintenance of the high character and standards of the Academy's past endeavors, is now absent on a tour of observation in the Far East. Judge William L. Ransom, our Acting President, who will preside at the evening session, has been a member of the Academy's Board of Directors for many years. It is to be noted that the Academy has derived incalculable advantage from its intimate association with Columbia University during its entire existence.

¹ Introductory remarks at the opening of the first session of the semi-annual meeting of the Academy of Political Science, April 11, 1930.

For the most part the topics chosen for discussion at the annual and semi-annual meetings of the Academy have had reference to questions of contemporary interest. Looking back over the long series of programs and published proceedings, the hasty inference might be drawn that the meetings have been arranged by opportunists, consulting newspaper headlines and seeking perchance to affect public opinion or political action in relation to some pending controversy. I am glad to say, however, that this has never been the case. The Academy does not engage in propaganda. Its encouragement of the scientific method of study and discussion in dealing with questions of immediate concern to society and to the state is all the better shown when its programs deal with topics chosen for their timeliness.

In making choice of today's general subject, the committee, I believe, has recognized most suitably the signs of the times. The State of New York has been engaged in an inquiry of unprecedented thoroughness with a view to changes in the present laws providing for the oversight of so-called "utilities" at the hands of the Public Service Commission. Several speakers today will bring to the Academy the fruits of their protracted labors in connection with this inquiry. Within a few years the power companies have grown with amazing rapidity. Hundreds, if not thousands, of local companies supplying light, power and kindred services have been amalgamated into larger units of operation, and have come under the control of still larger financial groups or holding corporations. Scientific discoveries and engineering skill, meeting the demands of the most prosperous nation in the world, have ushered in an age of electricity with a present that makes the recent past seem slight and tentative, and with prospects of immense future developments.

That the state must be cognizant of all this expanded activity, must recognize its monopolistic aspects, and must seek to harmonize the interests at once of invested capital, intelligent initiative, and the consuming public, is generally admitted. The topic of today's sessions, therefore, lies within the field of political science, is susceptible of academic treatment, is of immediate and absorbing interest, and is therefore well chosen for the consideration of this body at the present moment.

We have for the forenoon session the general subject of state regulation. Immediate problems of public control will form the group subject of the afternoon's addresses. At the dinner session this evening the broad presentation of the issues of state control, as we forecast the future of electrical services and supplies, will be presented by speakers of the highest qualifications.

The group of forces and characters involved in this general issue of governmental control over the stupendous activities of the utility corporations, presents itself to my mind as something that might be given a stage setting, as if it were assuming the form of a drama—perhaps I should call it a modern type of miracle play. The stage is disclosed as one crowded with personages—many of them symbolical, while many others appear without disguise as well-known fellow-citizens.

At the center of the platform there looms up a gigantic figure, clearly emblematical, and representing the so-called "Power Trust"—this phrase not applying to any single corporation, but to the monopolizing tendencies of the great utility undertakings. Equally conspicuous is the figure of "Uncle Sam", symbolizing not alone the federal authority but the governmental function, whether national, state or local.

The audience is the plain public, and the stage is set with a view at once to instruct and to sway opinion. The audience obtains the impression that two contending influences are about to present themselves. One of them seeks to convince Uncle Sam that he must curb, shackle, subdue or destroy the Power Trust. The other influence is endeavoring to have it appear that this great agency, as thus symbolized, is in the nature of the case essentially a benefit-conferring public servant, who ought not to be hampered in the extension of his activities.

Behind Uncle Sam, urging him to proceed vigorously, if not destructively, we find a group of symbolical figures, associated with personages more or less well-known, especially in the sphere of active politics. This group, though not entirely in accord as to methods of attack, are united in the sense of suspicious or even hostile sentiment toward the great figure of Capitalism in the form of organized utility service.

The group purports to speak on behalf of the citizens as a whole, and of government as the main reliance of democracy.

On this side of the stage the Spirit of Socialism is a conspicuous and an attractive figure, attired in modish dress of European design. The Spirit of Communism is in no such pleasing guise, but is pressing forward in a bright red gown wearing headgear of Moscow pattern.

An emblematic masculine figure representing Political Partisanship possesses several hats which are changed from time to time for reasons not always clearly apparent. This rather aggressive figure of partisanship is supported on the right hand and on the left by two theatrical persons made up to look as much as possible like the late William Jennings Bryan and the late Robert M. LaFollette. They represent the anti-corporation and anti-monopoly contentions and controversies that have survived through several decades, from a time when circumstances were almost as different as possible from those that exist today.

Behind these ghostly figures of the past one recognizes a considerable number of well-known present-day personages, more or less prominent in politics and affairs, who proceed eagerly to offer Uncle Sam their personal lives and fortunes at the forefront of what they regard as the impending fight against the gigantic figure of incarnate Power, and his unpatriotic minions. Everyone on that side of the stage is trying in his own way to arouse Uncle Sam to a sense of some imminent danger from an aggrandized and a usurping Power Trust.

Turning our gaze to the other side of the stage, we see a group made up in part of symbolic figures, and in part of well-known men wearing no disguises and appearing in ordinary business costume. The audience eagerly singles them out and recognizes them as having offices in Wall Street, in Philadelphia, Chicago, Boston, San Francisco or elsewhere. They do not seem to be excited, and their attitude is neither that of menace nor of apology.

Our attention, however, is held, not so much by these so-called magnates of the electrical world and the utilities corporations, as by several striking figures, evidently symbolical. They wear the robes of the classical period, as if they were goddesses descended from Mount Olympus. These white-robed, star-eyed, and dignified ladies, as it soon appears, are

on the stage to represent the engineering professions and the scientific spirit of the research laboratories.

The audience is asked to learn from these personages that a succession of marvelous inventions and discoveries, applied to the service of millions of people, has given the giant Power Trust his immense proportions and his obvious strength. They suggest that he is the emblem of organized efficiency, in the distribution of the benefits accruing from the direct and indirect uses of electricity.

On behalf of this group it is urged that human welfare has so much to gain from science that in spite of some past mistakes and present faults of the giant agency (which they frankly admit Uncle Sam ought not to ignore), more harm than good might result from a kind of regulatory effort that would check and hamper a career that is upon the whole a beneficent one. In short, they ask the audience to believe that the giant is, in the main, a public-spirited as well as an amazingly capable servant of the entire community. The more important of the business leaders, grouped behind these serene representatives of science and invention, look with approval upon the leadership and guidance of those who seek new truth in the realms of research. They think themselves in harmony with the times. They are optimists in an expanding age. They claim this age as belonging more distinctly to them, and to the scientific people symbolized by the Greek goddesses, than to certain of the reminiscent politicians who have been glowering at them so distrustfully from the other side of the stage.

With the stage thus set for what seems to be a tableau rather than a play with some definite action, the audience wonders what is to break the spell. The curtain drops, and soon rises again upon a scene somewhat transformed. There has come forward a figure, now holding the center of the stage, wearing a dark robe with trimmings of ermine and looking, let us say, like Shakespeare's Portia or like Judge Florence Allen of the Ohio Supreme Court. It appears at once that this personage represents, in an allegorical way, the Spirit of Political Science. It is proclaimed that there is such a thing as the academic method of disinterested inquiry in the sphere of government and the state. It is argued that some questions

of public concern can be answered better by sincere efforts at investigation than by political controversy or by accusations and indictments.

It is evident in this re-arrangement of the stage that Uncle Sam is disposed to welcome the symbolic personage who represents the study of facts, and the attempt to shape public policies in accord with ascertained realities. On his part Uncle Sam is willing to make this Spirit of Political Investigation not only a respected member of the cast, but a particular protégée. The giant Power Trust on his part admits that he had on former occasions resented this personage as intrusive and as a theoretical young meddler. He had confused her in his own somewhat stupid way with the more gaily appareled personage representing Socialism. Beholding, however, the welcome that the laboratory ladies are bestowing upon the newcomer, he steps back courteously to await proceedings. He offers to assist if possible, and promises, at least, not to contend by unethical methods against the results that might follow from processes of study and investigation. The Greek characters representing Physical and Chemical Research, and Engineering Progress, extend the hand of fellowship and good understanding to the embodiment of Political Science.

With the personage in the judicial robes taking the chair, it is agreed that the giant Power Trust is to be subjected, not to trial as if under indictment, but to reasonable and unprejudiced investigation. It is desired to verify certain principles of regulation and control, and to see if the giant can serve the public better under revised rules and methods. On both sides of the platform it is admitted that Uncle Sam's position as final authority must suffer no disparagement. He represents sovereignty, whether in the nation or in the state, even as (for purposes of this stage setting) the giant Power represents a congeries of corporations operating under federal and state auspices.

If I should carry this whimsical account of imaginary stage scenes any further, you might think me not duly mindful of the dignity of the present occasion. Let me, then, say a few words to restore my standing, and to bring us directly to the program of the forenoon. Some of us present today have been so situated as to have dealt, for a long time past, with

these issues of the regulation of public service corporations. I could name men still active and influential who were once called "radicals" or "socialists" by the corporation leaders, but who are now reproached as being ultra-conservative by a new generation of "radicals".

These men would merely say that conditions have changed. Railroads which once resented regulation, whether of practices or of rates, are today almost abjectly submissive to legislatures and to standing commissions. They no longer assume to control state politics in their own interest. Public franchises are fully recognized as assets of the community, national, state or municipal. Political Science may well consider those former conditions; and, in dealing with present methods of state regulation, it may properly ask to what extent the earlier dicta have become obsolete. Besides the interstate problems of control over steam and electric railway service, we have new problems relating to the use of the air for aviation and radio broadcasting, as well as the problems of electrical development and distribution.

The principle of public regulation is no longer in dispute. Its methods and its extent are practical questions. There has come about a remarkable change of viewpoint and motive, on the part of those who control public utility corporations. They employ thousands of scientists in research laboratories, and seek their own success chiefly through the rewards that come legitimately from the rendering of improved service. Thus the harm that unregulated monopolies might inflict by arbitrary methods or charges seems to be slight when compared with the benefits that may be conferred through the further achievements of science. Fortunately, most of the leaders in control of public service corporations today are as far as possible from the arrogant mood that was said to characterize certain captains of industry and transportation several decades ago.

The present leaders honor Thomas A. Edison, for example, as typifying the unselfish life and transforming discoveries of the laboratory workers. They pay tribute to science in all its fields of service. They have contributed without stint to the support of research in the medical field, and have been among the foremost to honor such eminent leaders in the

sphere of public health as Dr. William H. Welch. Their own success, both present and future, is bound up with the success and prosperity of the American people.

Happily, therefore, the real and necessary problems of public regulation can be dealt with in a favorable atmosphere. As between the two sides of controversies that were raging when I was a Western editor forty years ago, I might at times have been charged with what were, in some quarters, called "anti-corporation" tendencies. But those controversies are now of the past, because circumstances have changed. The principles of political supremacy have gained an acceptance that was bitterly disputed forty years ago. It is the task of government today, as it is also the task of industrial leadership, to coöperate beneficially. We should lose nothing of the value of the extraordinary initiative, and the freedom of opportunity, that have made privately controlled business so successful in the United States.

We still have greedy and speculative explorers, bent upon seizing natural resources and exploiting them in their own interests regardless of the public welfare. The best thinkers and ablest managers in the work of supplying the public with power and light are not in sympathy with the squandering of resources, or with the alienation of public rights. There are also financial adventurers, doubtless, whose methods in seeking to amalgamate or to control numerous power companies of earlier origin ought to be fully investigated, in the interests at once of investors and of consumers. We are on the eve of stupendous expansions in the extent and the variety of the services to be rendered to the entire community by the distribution of electrical power. Statesmanship calls for the thoroughgoing study of these new situations, that are presenting themselves in changing aspects, from year to year, almost from day to day.

HAVE THE STATE COMMISSIONS FULFILLED THEIR INTENDED FUNCTIONS?

HENRY C. SPURR

Editor of Public Utilities Fortnightly

THE answer to the question whether the state public service commissions have fulfilled their intended functions will depend to a considerable extent upon what one thinks the regulatory aim was.

If the commissions were expected to cut existing rates in two whether this would pay the utilities or not, the commissions have failed. If the hope was that the commissions would put utility service within the reach of rich and poor alike without respect to its cost, or its effect on various groups of consumers, the commissions have not come up to expectations. If it is the sole business of the commissions to protect the ratepayers, the commissions have never functioned as intended. Finally, if our standard is perfection, we must admit that the commissions have fallen short of it. We could no more say that our commissions are functioning as they should than we could assert that our courts, our schools, our colleges, or even the states themselves are doing so, for all of these institutions are human.

On the other hand, if we do not demand the impossible, if we think that all the commissions should reasonably be asked to do is so to regulate the utilities as to secure adequate and non-discriminatory service at rates which will encourage development because fair to both the ratepayers and the utilities, it is possible to say that the commissions have been acting in a creditable manner.

If we compare state commission control of utilities with control prior to 1907 when the commissions began to be set up, and if we consider the tremendous development and improvement in utility service since that time, we can confidently assert that commission regulation has functioned much better than direct legislative control, state or local, and that commis-

sion regulation has at least not been a stumbling block to utility development.

Everyone who knows that commission regulation has been subjected to savage attacks at times, followed by investigations, often by hostile legislative committees, and that invariably these investigators have advised continuing and stiffening the commission laws, can safely conclude, without any other information on the subject, that the commissions must be functioning fairly well; otherwise the recommendations would have been that the commissions be abolished.

State commission regulation is theoretically sound. It should be better than regulation by the free play of competition, by contracts, or by direct legislative action, state or local. Cut-throat competition in the utility field is now generally held to be bad for the public. The contract method has serious drawbacks. If we do not deal with the utilities through contracts, regulation must be by legislation, state or local. Local legislation has its disadvantages. For one reason—although there are others—the locality is too limited a unit of control.

If the state is to regulate, it must do so either by direct legislation or through the agency of a commission. Regulation by a commission ought to be better than regulation by direct action of the legislature. The legislature does not have time to ascertain facts upon which specific regulatory action should be based. It is not in session throughout the year. It could not act quickly in an emergency such as that created by the war. A commission, on the other hand, may be continuously in session. It can ascertain the facts upon which its legislative and administrative action should be based. It can conduct hearings and give both sides a chance to produce their evidence. Theoretically, I repeat, this would seem to be the best form of regulation. How has it worked out?

We can probably all agree that the new system was intended to end existing evils. These evils were wasteful struggles between utilities for the occupation of fields not capable of supporting more than a single utility; unfair discriminatory practices; political bickerings between local authorities and the utilities over franchise rate contracts; and arbitrary actions of the legislature, often inspired by political motives, in fixing rates by direct legislation without an adequate knowledge of

the facts. The purpose of the new regulatory laws was to put the utilities under the control of a state agency equipped to assure the public of adequate service on fair terms and the utilities of a reasonable compensation.

Good service at reasonable rates was the chief aim. Elimination of losses due to rate wars was an incidental policy embedded in the commission laws for the purpose of obtaining the best service at reasonable rates. The elimination of unfair discrimination in respect to both rates and service, a notorious evil, was a major purpose of the commission laws.

With these main objects in view state commission regulation was launched. Over the utilities to be regulated the commissions were given general power of supervision and control. They were authorized to enter upon utility premises for the purpose of inspection; they were given authority to examine employees and records; to prevent unreasonable rates and discrimination, local and personal; to fix rates; to value property for the purpose of determining rates; to establish joint rates; to compel the filing and posting of schedules; to prescribe forms of schedules, reports and uniform accounts; to regulate service and to prescribe standards of service; and some of them were given supervision over security issues.

What the commissions were given power to do they were of course expected to do. So it is apparent that their functions were to be partly legislative, partly administrative, and partly quasi-judicial.

Since their establishment the commissions have heard and decided thousands of disputed questions brought before them. They have exercised their regulatory powers without controversy in thousands of other cases. They have often, on their own initiative, moved against the utilities.

By the exercise of their power over certificates of convenience and necessity they have protected the utilities, the public and the ratepayers from wasteful competition.

They have established uniform rules of accounting, a public service of undoubted value.

They have forbidden unlawful discrimination in the shape of concessions to various classes of consumers such as the government, municipalities, employees, officers, stockholders and large consumers.

They have prevented the discontinuance of service because of disputes over bills.

They have compelled reparations for overcharges.

In a number of states where commissions have the requisite power, they have maintained a close supervision over security issues. The present California Railroad Commission, for example, since its organization in 1912, has supervised the issuance of nearly \$3,000,000,000 of utility security issues.

The commissions have established standards of service and enforced them. They have ordered extensions of service where they would otherwise not have been made. They have prevented abandonment of service where it would otherwise have been abandoned. They have ordered physical connections between telephone lines and railway lines which would not have been made except through the compulsory action of the commissions. They have maintained laboratories for standard tests for the purpose of improving service.

They have eliminated many grade crossings and apportioned the expense of making the highways safe from crossing accidents. Pennsylvania, for instance, spends \$1,000,000 a month for the elimination of dangerous crossings. The commission has supervised the expenditure of \$180,000,000 for that purpose. In addition to elimination, the commissions have ordered the protection of grade crossings by modern signaling devices.

They have investigated accidents for the purpose of establishing measures for their prevention. They have inspected utility property for the purpose of insuring safe and adequate service. This is an important administrative function. As a result of inspection of overhead electric construction by the staff of the California Railroad Commission, for example, 350,000 potential causes of accidents to utility operators or to the general public were corrected upon the orders of the commission.

The commissions are handling an enormous number of informal complaints. The New York Commission gets over forty of these for every working day. These complaints are generally regarded as minor, but they are important to the customers involved. The complaints relate to service, discontinuance for nonpayment of bills, overcharges, and many other

matters which constantly arise between business concerns and their customers. These informal complaints are adjusted through the office of the commission. Often a single letter is all that is necessary. Sometimes a personal investigation by the commission's staff is required. If action is not secured, the matter becomes a formal complaint to be disposed of by the commission.

Here is a story by a small town publisher in Oklahoma. His printing shop was located in a building in which there was also a small machine shop. He thought his bills for electricity were too high and upon investigation found that his shop and his neighbor's shop were connected to a single meter and that he and the other tenant were each charged for the full amount of current registered on the meter. He reported this to the office of the company but got no redress. He reported it a second time. No response. Then he wrote to the Corporation Commission. Within thirty-six hours two men from the company were in his shop to fix the meter and figure out a proper adjustment of his bill. This was better than an expensive court action.

The very fact, moreover, that complaints may go in this informal way before the commission and receive the commission's attention is likely in most cases to secure prompt action from the utilities when complaints are made in the first instance at their office. There is an entirely different atmosphere at the headquarters of the public utilities with reference to complaints than there used to be before commission regulation. Without doubt this is largely owing to the fact that complaints can easily reach the ears of the commissions and that if the utilities do not listen to the first plea the commissions will listen and compel adjustments.

In respect to all of the matters mentioned, commission regulation has functioned admirably well. There has been no serious complaint as to the manner in which the service of the companies has been regulated. The service of our American utilities as a whole is probably the best in the world.

There is no question but that they have eliminated local politics from regulation and that they have in a large measure done away with arbitrary legislative action in regulation.

Whatever complaint there has been as to commission short-

comings in respect to any of the activities mentioned bears upon a question which I now come to. If you will examine the charges that commission regulation has broken down, or is halting and beating time, you will find that they are mostly based on a mere difference of opinion as to the reasonableness of rates. The idea is that the utilities are still charging exorbitant rates and that the commissions have not been able to stop them, either because the commissions are utility-minded, or limited in power, or inadequately financed, or else because the courts are blocking them. If we go to the bottom of the matter we find that all roads of discontent lead to that source of controversy known as the rate base.

I shall not attempt to discuss the merits of that question; but let me in passing state a fact which is often overlooked. When the commission movement was started, valuation of utility property was the ratepayers' panacea for low rates. They had succeeded in getting a rule from the Supreme Court to the effect that railroads were entitled to earn a return on no more than the fair value of their property. The ratepayers, in the interest of low rates, even tried to have the Supreme Court announce the rule that present value is to be measured by the cost of reproduction, but they failed in that. The Supreme Court held that other factors must be considered, including the cost of the property.

At the time the commissions were established there was a widespread belief that utilities were charging extortionate rates based on watered stock. What the public at that time wanted was to limit the return to the value of the property, rather than to allow the companies to pay dividends on water, so valuation was made the cornerstone of most of the new laws. Congress felt the impulse of this new movement and ordered the Interstate Commerce Commission to value the railroads. There is not the slightest intimation in any of the statutes that the legislatures expected the return to be based on prudent investment. The evidence to the contrary is overwhelming.

It may therefore be said that even in limiting the return to the fair value of the property, the courts have not prevented the commissions from fulfilling their functions as originally intended. About all that can accurately be stated by those

who declare that regulation has not turned out as expected in respect to rates, is that the values allowed have been too high; and that of course simmers down merely to another difference of opinion.

But suppose for the sake of our inquiry we overlook that. Let us assume that the fathers of regulation were wrong; that times have changed. Suppose we say that every decision of a federal court declaring a utility rate confiscatory is wrong, and that every decision of a federal court in favor of a utility company is an interference with commission regulation. How have the commissions functioned with respect to rate control in spite of this handicap, and to what extent has state regulation been interfered with by federal court decisions?

Before the war the tendency of the commissions was to reduce rates. During the war they increased rates. Recently they have been reducing them again.

Some time ago I asked the commissions to estimate the savings which had resulted from decreases in gas and electric rates for the last five years through the efforts of the commissions. Here are some of the estimates furnished by the commissions.

California, five years, \$6,500,000 (cumulative savings not estimated).

Georgia, for the last two years, \$1,500,000 per annum.

Indiana, reduction in electric rates for five years, \$6,000,000. Reduction in gas rates for the last two years, \$200,000.

Maryland, conservative estimates of savings to gas and electric consumers since 1923, between \$13,000,000 and \$14,000,000.

Michigan, savings through rate reductions in five years, \$14,597,388 for electric service, and \$1,175,171 for gas service.

Missouri, reductions in rates since 1928 through formal investigations and conferences with utility operators, over \$2,000,000 a year.

New Jersey, estimated savings to gas and electric consumers for 1929, \$8,134,810, based on production over a period beginning in 1924.

Pennsylvania, savings of approximately \$25,000,000 a year over rates that were in effect in 1914.

Oklahoma, estimated savings, \$3,730,000.

Utah, savings approximating \$1,000,000.

Virginia, savings for five years, \$2,675,000.

Henry A. Frazier, recorder of the California Railroad Commission, says that for every dollar expended by the Railroad Commission in regulating the utilities, there have been returned to the ratepayers \$7 in reduced utility charges, irrespective of any savings accruing because of the refusal of the commission to sanction requested increases in rates or because of the part played by the commission in winning substantial reductions in interstate rates.

Certainly a return of seven dollars on every dollar invested is a handsome profit for the public on the regulatory enterprise. And we could hardly say that commission regulation is a failure even if we thought it should have produced a return of eight dollars instead of seven on every dollar invested.

How far have the federal courts interfered with the proper functioning of the commissions, on the theory that the federal court decisions are wrong? The utility companies have been represented as rushing headlong into the federal courts to thwart the state commissions. This has even been said to be an interference with state rights. Statements of this sort not only show a lack of understanding of the value of fundamental liberties which the courts protect, but they are a gross exaggeration of the situation.

Take New York State. From 1921 to 1928 inclusive, the New York commission entered 11,440 formal orders in proceedings brought before the commission. Of these 11,440 cases only three were appealed to the federal courts. Only two involved the question of rates. This does not appear to be a very serious interference on the part of the federal courts with the functions of the state commission in New York. The same is true in other states although in varying degrees. Chairman Henry C. Attwill, of the Massachusetts Department of Public Utilities, has said that since 1869 Massachusetts has attempted to regulate railroads and railways by commissions, and since 1885 gas and electric companies. He doubts that in all that period of time the decisions of the Massachusetts commission have been reversed by appeals to the courts more than ten times. The present department has been reversed

but once and the chairman declares that in rate cases he knows of no instance of reversal.

The fact is that the number of appeals to federal courts as compared with the total amount of business done by the commissions throughout the nation is negligible. The disposition of the utility companies, especially the electric utilities, has been to avoid litigation. Where it has been necessary to thresh out disputed questions before the commissions the tendency has been to abide by the commission decisions. We have had a few great rate cases which have gone to the federal courts and which have been expensive and slow-moving, but these are only exceptions to the general rule. Commission procedure is usually final.

The disposition to abide by the decisions of the commissions is not due to the fact that the commissions are in practice following the Supreme Court value rule, and that the utilities are insisting on it. In Massachusetts, for example, where they have had so few court appeals, the utilities have never been allowed to earn a return on the value of their property. A former chairman of the Wisconsin commission once said that out of hundreds of rate cases before his commission he could count on the fingers of one hand the utilities that had stood out for a return on the full value of their property. In my judgment a law in New York State requiring the valuation of all utility properties would result in a benefit to the utilities rather than to the ratepayers, because the probability is that the utilities are not now insisting upon a return on the full value of their property.

It is said that the commissions are not functioning as intended because they have tended to become too judicial. The theory seems to be that the utilities have an ample safeguard in the courts; that the utilities are able to protect themselves, but that the ratepayer must be looked after by the commissions. But if the utilities on the one hand are going to receive no protection by the commissions from the unjust demands of the ratepayers and on the other are to be considered as blocking regulation by appeals to the courts, they are certainly not getting much encouragement.

The contention that the utilities should not have fair judicial treatment before the commissions finds no support either in

ethics or in the statutes. To adopt such a policy would be only to invite what the critics of regulation profess to deplore, that is to say, appeals to the courts. Utilities are entitled to fair treatment somewhere. If they cannot get it before the commissions they will be forced into the courts. New York furnishes a good illustration of that fact.

I have already said that out of 11,440 formal orders entered by the present judicially minded commission, between 1921 and 1928, there were only three appeals to the federal courts. From three regulatory acts of a partisan-minded legislature during the same period there were twenty-seven appeals to the federal courts, one of which is pending. In all the others, the acts were declared unconstitutional because confiscatory.

It is charged that the tendency of the commission to assume the judicial rôle puts a handicap upon the ratepayers because they are not able to hire as high-priced lawyers and experts as the utilities. But if we judge by the results of the commission decisions, the supposed handicap has not been very serious. The dissenting opinion of Mr. Justice Brandeis in the Southwestern Bell Telephone case has been regarded as the ratepayers' Magna Charta. In support of his opinion, Mr. Justice Brandeis cited 363 cases decided by the state commissions from 1920 to 1923. Of these, 358 were in support of Mr. Justice Brandeis' views, and only five were opposed. This is not a very bad record for handicapped ratepayers before "judicially minded" commissions. The fact is that notwithstanding any supposed disadvantage the ratepayers may labor under by reason of lack of legal and technical talent, they have more often been successful before the commissions than the utilities in contested cases.

Moreover, the theory that the commissions should be partisan to ratepayers is unsound as well as unethical. The ratepayers do not constitute the public any more than do the stockholders. The people of the entire state are the "public". The ratepayers and the stockholders are both moved by a private interest. Utility service has a much wider interest than that of the locality in which it is rendered. If all of the utilities in the City of New York were to shut down for a week, the welfare of the people of the entire state would

be affected. It is therefore to the interest of the entire state that there shall be a continuous flow of utility service and to that end, that rates shall be fair and non-discriminatory on the one hand and on the other that they shall not be so low as to cripple the utilities.

Consequently the preservation of the public interest in public utility service demands that private interests of the ratepayers and stockholders shall be balanced for the public good. It is that public interest which the commissions are supposed to protect; it is that interest they have endeavored to protect by acting in an impartial, judicial manner. I believe that in this respect they have functioned as intended. I hope they always will.

This tendency of the commissions to be fair to the utilities must have been greatly heartening to capital. It is different from the political and partisan methods which formerly prevailed in dealing with regulatory questions. The commission method has undoubtedly greatly accelerated the flow of capital into the utility field. The development of utility service has unquestionably been hastened by this type of equitable commission regulation. It would be hardly too much to say that it is regulation's greatest contribution to the public welfare.

Commission regulation has, of course, been far from perfect. Without any change in the laws governing their functions, the effectiveness of the commissions could be increased by larger appropriations, providing better compensation for the commissioners and their staffs. Their powers could also be enlarged and regulation could be more extensive than it is. Utilities could and should be subjected to federal control of interstate matters which cannot be reached by the states. But how far regulation should be extended over the conduct of the business itself is a debatable question. I believe that regulation can be overdone to the detriment of the public.

If wasteful competition between utilities of the same kind is prevented; if satisfactory accounting practices are enforced; if standards of adequate service are established and enforced; if reasonable complaints are satisfied; if unfair discriminatory practices are abolished; if security issues are scrutinized for the protection of investors; and if scientific rate schedules are insisted on, containing rates which will permit fair treatment

of various classes of consumers and which at the same time will promote the expansion of the service, we have gone a long way toward the end of the road. The courts will never allow state commissions to become managers of public utilities, nor would it be wise to do so.

When it comes to the question of keeping the return for the service down to the lowest notch possible by forcible commission action, I believe we are often penny-wise and pound-foolish.

The utilities have made the people of the country richer, not poorer. That means that they have never charged the full value of the service. As an economic proposition, no business could have expanded to the extent that the utility business has on the basis of extortionate rates.

There was once a time when our great modern utility services did not exist. These services have been presented to the public by inventive and commercial genius, by men of vision who have had the courage to risk their money. The demand for their service is a created demand. The demand exists because the service has been demonstrated to be of great value. It would not exist if the people did not believe that it was worth much more than has ever been asked for it. The mere size of the business is a complete answer to the charge of extortion.

One inventor who was also the organizer of the business of exploiting his invention, made a fortune of \$20,000,000 in twenty years. But his invention saved the people of the country \$120,000,000 a year. The people got \$120,000,000 a year in return for \$1,000,000 a year. Why be too finicky about that \$1,000,000 payment?

Out in a country district a telephone subscriber threatened to sue the company for \$60 which he claimed he had lost because his telephone was out of order for three days. At that rate his service was saving him \$600 a month. Why claim that the company is picking his pocket by a charge of \$10 or \$20 or even \$30 a month for that service? Assuming that he exaggerated his losses for the three days his phone was not working, his telephone service was undoubtedly putting at least \$2 in his pocket for every dollar the company charged him.

If, then, our utilities are making the people richer every day they operate, why get too much wrought up over the question whether they should earn six or seven per cent on the value of their property or on their actual investment in it?

The men who have presented this gold mine to the people are entitled to something for themselves. If they are making the people richer, as they are, they should have something more than the lowest possible wage. In my judgment they are entitled to a liberal wage. But aside from that, I think the public would get more by the adoption of this policy.

It seems to me that we do not need to be very much concerned about this question of utility return, because in the case of most of the utilities the people are pretty well protected by competitive forces which are still at work. Gas is now a heating proposition and in constant competition with coal and oil. Domestic electric service would be a luxury were it not for commercial service, and commercial service is on a competitive basis. Control of rates in the electric railway field would seem to be no longer necessary, because competitive forces are in the saddle and seem to be riding roughshod over arbitrary attempts at regulation. I do not say that we should not attempt to regulate the return, but I do think that we should not endeavor to carry the answer to the problem to the tenth decimal point.

All things considered, I think the commissions have functioned remarkably well as originally intended. They have eliminated local politics in regulation. They have to a large extent prevented arbitrary legislative action. They have protected the public and the utilities from wasteful competition. They have eliminated discriminatory practices. They have established uniform accounting and reasonable standards of service. They have adjusted an enormous amount of complaints, and thereby not only satisfied utility customers but helped to build up better public relations between the utilities and the ratepayers. By a broadminded policy of dealing fairly with the utilities as well as their customers the commissions have accelerated the flow of capital into the utility field and thereby hastened development. They have not hesitated to increase rates as well as to decrease rates when necessary. They have not blocked development of the service.

In a word, they have made a tremendously important contribution to the public welfare.

Commission regulation, being a human activity, has been far from perfect. It may be strengthened, but it must not be carried so far as to defeat its purpose, which is the greatest economic good to the public.

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FACT-FINDING AND THE JUDICIAL FUNCTION IN THE WORK OF STATE COMMISSIONS

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REGULATORY COMMISSIONS have become the means through which the state has sought to exercise control over the relations of utility concerns rendering service to the public. The powers given to these commissions have been far-reaching and in many cases almost despotic. But the operation of these powers has always been governed by a fundamental precept clearly set forth in *Munn v. Illinois* (94 U. S. Rep. 113) as follows:

Rights of property, and to a reasonable compensation for its use, created by the common law, cannot be taken away without due process; but the law itself, as a rule of conduct, may, unless constitutional limitations forbid, be changed at the will of the legislature. The great office of statutes is to remedy defects in the common law as they are developed, and to adapt it to the changes of time and circumstances.

It is obvious, therefore, that a commission must be governed by the law, and in making its findings as to "reasonable compensation" it must search for and determine the facts. The question arises what are the functions of a state commission? Is it solely a fact-finding body, or does it exercise a judicial function?

The word "fact" has a variety of meanings. For our purposes it signifies a state of things or the existence of things. A fact-finding body is one which seeks for and ascertains the facts material and necessary to be considered in order to arrive at a determination of fact.

What is a judicial function? As I understand it, it is the doing of something in the nature of the action of a court. Where there is the exercise of neither discretion nor judgment there is not the exercise of a judicial function. And still it is not always true that every function wherein judgment and dis-

cretion are exercised is a judicial one. Judicial function presupposes the use of mental processes in the determination of law or of fact and at times involves discretion as to how whatever power is to be used shall be used.

What a judicial function is does not depend solely upon the mental operation by which it is performed, or the importance of the act performed. The authority to determine the rights of persons or of property by arbitrating between adversaries in special controversies, coupled with the authority to declare the law as it should be applied to the facts found, or the authority to hear and determine when the rights of persons or property are the subject matter of the adjudication, confers judicial power and is the exercise of a judicial function.

It is held, and rightly so, that certain functions of the Public Service Commission are of a quasi-judicial character. I think this term is used only because it is not always possible to distinguish between purely judicial acts and those ministerial functions which can only be properly performed in one particular way. The courts have held that an office is a quasi-judicial one when it is invested with power to decide property rights, and other courts have held that quasi-judicial functions lie midway between those that are purely judicial and those that are ministerial or administrative.

The topic I am discussing should not have been made quite so inclusive, because the distinction between judicial and ministerial functions must of necessity depend upon the law of the state in which the officer or body possessing these functions is domiciled. I am only assuming what the law of the state may be in the case of other commissions, but can speak with some familiarity regarding that of New York State.

When the Public Service Commission of the State of New York was created, the statute itself was an advanced step in legislation. The construction and application of the provisions of that statute necessarily introduced questions of difficulty. The courts were careful in the earlier cases to go no further in the expression of judicial opinion than was requisite for the decision of the precise question presented. While the law itself is an ancient and fairly well developed science, regulation by the states is comparatively new, and, I believe, is still in the stage of development.

It had been well settled for many years prior to the enactment of the Public Service Commissions Law that the common law writ of *certiorari* issued to review only the decisions of inferior judicial or quasi-judicial tribunals. Yet we find that the common law writ of *certiorari* was early recognized as the proper manner in which to review the action of the Public Service Commission, although the courts recognized that official acts which were executive, legislative, administrative or ministerial in their character were not subject to review by *certiorari*. And the courts held that determinations of the commission establishing rates were quasi-judicial in their nature and reviewable by the common law writ of *certiorari*.

Here we must not be misled by names. The term "judicial" is used in judicial literature and opinions and in textbooks in two distinctly different senses. The action of an administrative or executive officer or board may involve the exercise of judgment and such action is quite often termed "judicial". The word so used is quite different from what is meant when we speak of judges as judicial officers, and the fact that public officers or agents exercise judgment and discretion in the performance of their duties does not make their actions judicial in character. But where a body is authorized and required to take evidence, and all parties interested are entitled to notice and a hearing, and after the findings of fact have been made, if such a body has discretion and may fix by its orders rates which in their very nature affect property rights, the order which it makes is clearly judicial in its character.

For instance, the action of the Public Service Commission in consenting to the discontinuance of a station on a line of railway is not an act merely of administration but is judicial in its character. The act is judicial because the law impliedly requires the commission to first decide a question of fact and then requires it to go further and exercise its judgment upon evidence determining whether or not a consent should be given. The question is between those patronizing the station and the inconvenience and monetary loss to the railroad company in maintaining the station and continuing to stop its trains there.

The grant of certificates of public convenience and necessity for the operation of motor-bus lines, for the operation of

electric systems, for the construction of steam and electric railroads, for the building of gas plants and for the construction of telephone lines is administrative and ministerial and also judicial.

The legislature has the power to fix maximum rates. Nevertheless, such power is not inherently and exclusively legislative. To the commission has been entrusted the duty of ascertaining facts and after a public hearing determining what is a reasonable maximum rate. And the commissions in these cases act quasi-judicially.

In many of its duties the commission is an administrative fact-finding body only, and to assume that it is wholly either administrative or quasi-judicial is to start in a wrong direction. Most critics of utility regulation have no idea of the character and amount of work performed by regulatory commissions in the larger states. They invariably argue that the commission's most important function, and to their mind the only function, is that of fixing rates. As a practical matter—and I speak of the New York State commission alone, although I am sure the record of the work of other commissions in the larger states would be substantially the same—rate cases constitute a small percentage of the proceedings heard in the course of a year by the public service commissions. Millions of dollars in security issues are reviewed and authorized by the state commissions. Thousands of proceedings involving the right to exercise franchises are heard. More than fifty informal complaints as to the service of utilities are adjusted every day by the New York State Public Service Commission. Continuous tests are made as to the quality, safety and proper purveying of the products of utilities. And the critics who, as I say, seem to base their judgment on the handling of rate cases, although I have never known of a single instance where the lowering of a rate was publicly praised, argue that regulation is a failure because certain rates have to be increased or not arbitrarily reduced.

When the commission acts upon its own initiative, as it very frequently does, and proceeds to take testimony and hear and determine contested questions of fact and fix rates, and decide in the same manner the form of rate orders, and even pass on joint rates and distribute joint fares between connecting car-

riers, the questions are more than administrative or ministerial ones. The order must be and is judicial in its character. So I think we can safely assume that whether the proceedings before a Public Service Commission are to be regarded as legislative or otherwise does not depend so much upon the character of the body before which they have taken place as upon the character of the proceedings themselves. And it is easy then to see that the power granted to and exercised by the Public Service Commission includes a great deal more than may be strictly defined as the legislative act of fixing rates.

The Court of Appeals of this state, in one of the first and most important appeals which went to that body from a determination of the Public Service Commission, said that the paramount purpose of the Public Service Commission was to protect and enforce the rights of the people. And the court mentioned a number of duties involved in thus protecting the rights of the public. It is well to bear in mind that the first duty mentioned was that public service corporations had to render to the public reasonable and proper service, maintain their equipment in good order, operate with safety to the public, and fulfill all reasonable demands of the public for service. All these things were to be done and the corporation was to receive a proper and reasonable compensation therefor. One of the legislative purposes, the court said, was to prevent utility corporations from issuing stocks and bonds without actual consideration therefor, or for improper purposes. But the commission was given only such duties and opportunity for the use of discretion and judgment as could be exercised under the express limitations of the statute. And no powers beyond the statute could be exercised by the commission. At the same time, it was given no power in contempt proceedings or to impose or collect fines. It could sue in the courts for penalties and it could call upon the courts to restrain violations of law and to enforce its own acts.

Nevertheless, the courts in passing upon determinations of the commission have said that they had no power to substitute their judgment of what was reasonable in place of the determination of the Public Service Commission, and that the court could only annul the order of the commission if it violated some rule of law.

It was not intended that the courts should interfere with the commissions or review their determinations further than was necessary to keep them within the law and to protect the constitutional rights of the corporations over which they had been given control.

The critics and detractors of the electric industry at first undertook to attack that most successful of our industrial enterprises by asserting that proper vigilance was not being exercised over rates and charges, because there had been a breakdown in the administration of the regulatory commissions. They have since shifted their ground and now allege that the function of the commission should be that of a prosecutor of the utilities. This was not the original concept of the character of the commission, is not now the proper concept, and never should be. It is obvious that if the commission is to represent only the customers of the utilities and act only in their interests the sole source of protection the utilities will have is the courts, and this will result in making the courts an even greater influence in the determination of utility problems than they have ever been before. It will thus aggravate the very condition that commission and utility critics have been denouncing, namely, that there has been too much recourse to the courts upon questions that should be decided by the commissions.

The issue thus raised is one of supreme importance, and it must be met and settled by direct and definite arguments and methods. There is always a disposition on the part of politicians to pander to what they believe to be public sentiment against capital. In fact, this is a favorite game of legislators and other office-holders. This attitude must be curbed by frank discussion of economic questions and a determination to assert the mutual rights and interests of capital and those whom it serves, in other words, the public. In this way we shall be maintaining the sound principles of American business and American justice. If justice is denied, business will suffer. If business suffers, the public is the victim.

There are certain inherent principles in the regulative theory. It was established to secure fair dealing for all and to prevent persecution of any interest. These principles are simple and should be well understood.

1. The consumer is entitled to just and reasonable rates for the service or commodity he buys from the utilities.
2. He is equally entitled to ample service and every possible measure of safety in the supplying of that service.
3. It is the duty of the commission to see that the consumers are given adequate protection in the enjoyment of these rights.
4. The property of the utility is private property, devoted to a public use, and the investors in that property are entitled to every protection of the law (equally with the consumers) and to a fair return upon their investment.
5. Their investment is entitled to protection against the unfair attacks of politicians and self-seeking complainants, and they have a right to look to the commission for this protection.

Unless the interests of the consumers and utilities receive equal protection both will be harmed. If the utilities are subjected to unfair attack their credit will suffer, and this will prevent their attracting the required capital with which to give good service and extend their operations. If this happens the public is the sufferer.

In order to determine that rates are fair and that service is adequate the commissions must be informed regarding the activities of the utilities, and must have adequate staffs to accomplish this. To the extent that the means have been provided the commissions have been able to keep abreast of the operations of the serving companies. The testimony presented by the New York State commission to the Committee on Revision of the Public Service Commissions Law during the last six months is the best evidence that the work performed by the commission was very great and much more than should have been expected of it with the staff at its disposal.

Will anyone seriously assert that the question of determining the valuation of a property, be it great or small, does not require the exercise of a discretionary judgment? Does not the performance of that act possess all the character of a judicial operation? Efforts are now being made, I am aware, to render the determination of the value of utility properties a very simple and almost automatic proceeding by the rather frayed and heretofore unacceptable device naïvely called "prudent investment". The high priests of low and uncon-

stitutional valuations are now threatening that if their plans are not adopted, the municipalities must be authorized to create their own electric and gas plants and operate them in competition with the present utilities. In other words, by adopting rates that bear no relation to real costs, or hiding their real costs and deficits under the cloak of a municipal tax budget they will undersell the private companies and destroy their property. Similar schemes have been urged time and again, but they have never ultimately been successful with the American people. But the advocates of "prudent investment" have another possible panacea. Forced to admit that this theory has no present constitutional sanction, they urge that the legislature of the State of New York should adopt it, in the belief that such action will perforce move the Supreme Court of the United States to recant the doctrine of "present value", which is the law of the land. To put it in another way, a confessedly illegal legislative act, backed by unintelligent public clamor, is to dominate the judgment of the highest court of the land. Those who favor this policy know full well that they can always appeal to the greater number if they tell them that it is sought to cheapen the rates charged by the utilities. So the Supreme Court is to be coerced by the cries of the crowd. It is to be put in the position of Mr. Pickwick and his friends at the parliamentary election at Eatanswill. A roar went up for Slumkey, one of the candidates.

"Who is Slumkey?" whispered Mr. Tupman.

"I don't know," replied Mr. Pickwick in the same tone. "Hush. Don't ask any questions. It's always best on these occasions to do what the mob do."

"But suppose there are two mobs?" suggested Mr. Snodgrass.

"Shout with the largest," replied Mr. Pickwick.

Volumes could not have said more.

The questions upon which the commission must pass require the exercise of judgment and a discriminating sense of the fitness of things in order that proper decisions may be made. Whether service is sufficient or should be extended is a matter of evidence to be fairly weighed and justly determined. So with the other important questions of the valuation of properties, the extent to which those properties are depreciated, whether there is an element of going value in the property,

what the rate of return should be, whether certain charges made to the operating accounts are properly chargeable thereto; what just and reasonable rates are—all these questions are subject to varying views or opinions, and these views and opinions must be judged in the light of reasonableness and fairness. Consequently, the decision of the commission must be based upon the facts revealed in the testimony presented, and this decision takes on the attributes of judgment. This is why the commission is a quasi-judicial tribunal.

From their inception, the New York State commissions have been regarded as fact-finding and quasi-judicial tribunals. The Court of Appeals of this state has so denominated them, and a long line of decisions has never varied in the description of the quality of the service the commissions were expected to perform. As recently as March 27th of this year the Supreme Court, Appellate Division, Third Department, reversed the Public Service Commission in a case where the commission had held that it did not have the power to construe the provisions of the Charter of the City of Jamestown relative to the supplying of public utility service. Here is a significant passage from the opinion defining the Commission's function.

When the legislature enacted the Public Service Commissions Law, "it provided for a regulation and control which were intended to prevent, on the one hand, the evils of an unrestricted right of competition and, on the other hand, the abuses of monopoly." (*People ex rel. New York Edison Co. v. Willcox*, 207 N. Y. 86, 94). These aims required the establishment of a uniform quality of service, fair and just charges and rates, with no discrimination or preferences against or among the consumers, and the creation of a disinterested, detached and quasi-judicial forum in which the conflicting claims of competing companies or injured consumers might be equitably determined. With these aims to be attained, the legislature could not have intended to create dual control of the same commodity in one city.

Can there be any doubt that the court believes that the commission was created to be, and is, "a quasi-judicial forum in which the conflicting claims of competing companies or injured consumers might be equitably determined?" Does not the court answer with smashing directness the pretense advanced by Governor Roosevelt, that the claim that the commission is a quasi-judicial body is, according to his words, historically, legally and practically wrong. One cannot help

thinking that our charming Governor must belong to that school of thought described by Montaigne, when he said, "They arrogate to themselves the right to judge, and consequently to bend History to their own fancy."

I claim that the commissions must be both fact-finding and judicial bodies, and I further claim that the uniformity of railroad, motor bus and gas and electric light rates, and the standards of service of practically every utility in the State of New York, reflect the results of quasi-judicial determination on the part of the New York State Public Service Commission, deciding questions between different groups of consumers, any one of which may be denominated as the public. I have always believed that the commission is first a fact-finding body, and however much those who believe differently may disagree with me, I do not think that we can fail to agree that in deciding questions of fact between persons similarly situated, the commission must act in a judicial manner, with due regard to the law as interpreted by the courts.

I may stand alone in this, but I am opposed to the interference of government or of any branch of government with the decisions of the courts, and I am equally opposed to such interference with the decisions of a body which makes judicial determinations. I think that we have found in the record of our judicial bodies that long terms and adequate salaries have been sufficient incentive to attract men of the highest professional attainments, of unchallenged probity, and of surpassing industry. I do not believe that anyone investigating the history of judicial procedure in this country could fail to be impressed with the non-political character of the work done by our courts. I am confident that this should also hold true and will eventually be found to be necessary in the case of inferior tribunals possessing judicial functions.

A QUARTER-CENTURY OF REGULATION BY STATE COMMISSIONS

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Historical Review

IF we look back a full quarter of a century to the conditions existing between the public and the utilities we find a situation bordering on chaos. In the words of Thomas Mott Osborn, at that time a public service commissioner in New York State, evidences of "violations of monetary sanity, economic morals, to say nothing of economic decency", were apparent on every side. Scandals due to bribery and corruption of public officials were quite the order of the day. The consuming public suffered from discriminatory practices, intolerable service conditions and an utter disregard of complaints. Spasmodically, relief against the ruthless methods of some of the utilities was sought in the courts, or the state legislatures were moved to enact special legislation. When coupled with the variegated character of municipal ordinances such action but added confusion to confusion. Wasteful competition was also frequently invoked as a possible corrective. This served to increase the burdens on the public in the long run and only added to the general discontent. Furthermore, certain utilities were outgrowing local boundaries, thus inviting state action.

No better picture of the extortionate practices and political manipulations of the public service corporations can be found than in the reports of the legislative committees appointed in 1905 and 1906 to investigate the gas and insurance companies in New York. As counsel for these two committees Charles Evans Hughes had won for himself such popular regard and confidence as have been rarely accorded to any public character. It was but natural that, having by his fearlessness and devotion uncovered the sinister connection between political

control and corporate interests, Mr. Hughes should become the popular choice for the gubernatorial nomination in 1906. Despite the unanimous opposition of the political leaders, he became the unanimous choice of the Republican convention for the highest office in the state. Among all the Republican candidates he was the only one who survived his party's eclipse, to which through his revelations he had so materially contributed.

Clearly recognizing the chief causes of popular discontent and political disruption, he immediately urged upon the legislature the consideration of several far-reaching and constructive measures. Among them was a bill that would place the utilities as semi-public agencies under the control of a competent public authority. The machinations of the utility leaders and the general hostility of the legislature on the one side and the determination of a leader who understood the art of popular appeal on the other, made New York State in the fore part of 1907 the cynosure of the eyes of the country.

Although the credit of passing the first comprehensive public utility law goes to Wisconsin and although New York profited from the careful spade work that had been done by the Wisconsin lawmakers, it was the conflict between Governor Hughes and his own legislature that dramatized the Public Service Commissions Law for the country at large. Strange as it may seem, the bill finally became a law with the full backing of both parties in the Assembly and Senate. Thus the unlicensed freedom of the former period came to an end. It was superseded by a policy of state-wide regulation of these great monopolistic privileges in the interest of the public from which they are derived.

Other states quickly fell in line. There was a veritable epidemic of laws creating public service commissions, two or three states going so far as practically to copy the New York State act; in fact, the State of Maryland has in its law today the same misspelled words and faulty punctuation marks that appeared in the New York model.

The records show that by 1911 Wisconsin, New York, Massachusetts, Vermont, New Hampshire, Kansas, Ohio, Washington, Connecticut and Nevada had adopted regulation under a state agency. Eleven more states followed in the next two

years. And by 1921 all but one, the State of Delaware, had established a centralized agency with control over some, if not all, of the utilities. Many of the states have no such comprehensive authority as the two pioneers. For instance, eight of them lack jurisdiction over electric light and power companies, and in seven others this control is subject to more or less serious restriction.

Turning now to the New York State act as one of the two earliest and most comprehensive laws, we find that it has proved to be well suited to remedy the evils cited at the beginning of this paper. Amendments have been made from time to time, but after the inclusion of the telegraph and telephone corporations, originally omitted, these have not materially modified the scope and character of the basic act. This is in part due to the preliminary investigations which were made under the auspices of the Wisconsin Legislature and the Interstate Commerce Commission Law, from both of which the New York Legislature profited.

The law has proved to be sufficiently broad and it has permitted such flexibility that the commission was able at the very outset to adopt rules and regulations for current procedure that for the most part have been followed to the present day. This gives evidence of the caliber of the men appointed by Governor Hughes to the two New York commissions, one for the state and one for New York City. They adopted accounting and reporting forms; they made investigations of operations in the field and inspected appliances, machinery, meters, the quality of gas and the like, so that the standards of service in the different utilities were soon on a much higher level; they further took hold of the confused capitalization problems with a firm hand. In a word, such a standard of administration was set up that this experiment in regulation—one of the great contributions to the art of government—met with general approval, on the part of both the public and the utilities. The former enjoyed better service and, in large measure, was freed from the political manipulations of utility magnates in quest of favors; the latter had the satisfaction of dealing with a reasonably qualified and understanding agency and further found that the financial status of the utility organizations was immeasurably improved. The companies accepted their status

as instruments of the state, semi-public in character and therefore properly subject to reasonable regulation and supervision.

Criticism and Its Causes

But like other human institutions, the Public Service Commission is open to criticism and subject to improvement. I propose devoting the latter part of this paper to a consideration of the shortcomings of the commission. This seems called for in view of the criticism so rife at the present time, which even goes so far as to charge that commission control has definitely broken down. Outward evidence of this criticism is the fact that there has never been in any one year since the early part of the twenty-five-year period so much new legislation on utility matters introduced into the state legislatures as during the year just closed. Comprehensive investigations of regulatory laws and procedure were started last year in New York and Massachusetts, and several other states have considered the desirability of doing likewise.

As I look at it, this situation is due to a number of causes, chiefly the hearings before the Federal Trade Commission which brought to light dubious and reprehensible activities on the part of certain utility companies that have cast their shadow on the industry as a whole. It is also due to the investigation of the Federal Power Commission, recently made by the Interstate Commerce Committee of the Senate.

A second cause is the controversy that has been so vigorously carried on as to the development and control of the Boulder Dam, Muscle Shoals and St. Lawrence power resources. The proponents of public and private control have brought this issue to the eyes of the public in a great variety of ways, both direct and indirect.

A further cause has been the widespread speculation in utility stocks which are presumably capable of earning only a fair return on the investment. Connected with this speculation, if not the occasion of it, is the rapid spread of the holding company under financial influences. Although it has become in so many cases the dominating factor in the utility field with the absolute power of decision over the policies and personnel of the operating units, the holding company is as yet beyond the limits of public supervision. It is claimed by some that

this lack of supervision undermines, if it does not negative, control in the interest of the people.

Fourthly, more and more attention is being given to the perennial problem of fair value. This has come to the front as never before, perhaps largely because of the new price level, which has accentuated the differences between actual investment and reproduction costs. As a consequence the occasional rate decisions of the Supreme Court are commanding the attention of a constantly widening circle of more thoughtful people.

Finally, the astounding growth of this young industrial giant, the electrical utility, with annual gross revenues in excess of two billions of dollars and an annual construction budget of nearly one billion, has naturally raised the question as to whether existing regulatory agencies are adequate to protect the public interest.

This recital of causes may suffice to explain the recent flood of utility legislation and of criticism of the commissions in various parts of the country.

Personally, I do not subscribe to the charge that the principle of commission control has broken down. I am ready to grant that in practice the typical commission has fallen short of satisfactory standards and that these shortcomings should be remedied. Certain of them are due to the fact that the utilities themselves have definitely entered upon a new stage of development. This applies particularly to electricity. Recent changes demand that the commissions must have broader powers and material increases of staff and that the commissioners themselves have a broader outlook and great initiative. The routine of yesterday is not suited to the problems of today. The utilities are in a highly dynamic condition. They have outstripped the supervising agency, which like other administrative bodies is prone to become static, to hold to the established routine.

Review of Present Defects

May I now briefly summarize the shortcomings which, in my judgment, call for remedial measures. This recital does not aim to be exhaustive, but simply to outline the major problems of regulation which must be solved if regulation is to prove a workable substitute for competition on the one hand and for government ownership on the other.

1. *Personnel of the Commission.* The powers of a public service commissioner are so manifold and at the same time so technical and complicated that only men of unusual experience and capacity are qualified to undertake the duties of this office. Current duties may easily involve decisions which call for sound judgment on engineering, accounting, legal and administrative matters. At one time the commissioner is a judge attempting to hold the scales even between two conflicting parties. At another, he is vested with the necessary initiative so that he may see to it that the consuming public, however inarticulate it may be, is receiving high-grade service at the lowest possible rate consistent with a proper return for the service rendered. The power of initiative makes the commissioner more than a checker of reports and a recipient of applications. It implies leadership endowed with vision and the power to stimulate responsible utility executives to share in it. Although some commissions have from time to time utilized initiative to improve rate structures, to increase efficiency, to perfect methods of accounting and the like, a review of the reports of a number of commissions gives but little evidence of a consistent use of this power.

Like so many other influential public officials, the public service commissioners are not "career men", as the term is used in the State Department of the federal government. For the most part they are amateurs in the intricacies of public utility control and, in view of their relatively short term of office, they are tempted to take refuge in routine and red tape.

Furthermore, it is well known that public service commissioners more often than not have to meet the acid test of "political availability". No argument is necessary to prove that "political availability" does not connote those qualities which should dominate the motives and policies of such an official. Of these the first and foremost is clearly an independence of judgment that rises above influence and personal interest. A sense of trusteeship should be his lodestar, for there are few officials in the service of the state who wield such power and whose decisions affect the whole public in so many vital ways.

One of the most common and at the same time most misleading observations made concerning democratic government

is that ours is a government of laws, not of men. This need not be questioned when issues are contested before judicial tribunals, but it has only limited validity when applied to the day-by-day administrative processes of government. Laws are made valid or even invalid by the officials who are responsible for their administration and enforcement. Human inertia, indifference, arbitrariness and very frequently lack of staff personnel play a very large part in making government what it actually is. This observation applies in no small measure to the agency regulating the public utilities. If commissioners had been generally appointed with an eye solely to merit and capacity, much of the criticism of present-day regulation would never have become current.

2. *The Staff.* In any summary of the causes for the alleged breakdown of the public service commission, inadequacy of staff deserves a prominent place. One of the most common comments in commission reports has to do with the need of staff increases for the purpose of carrying on the work of the commission. For example, the New York State commission in the year 1909 began making a plea for more traveling auditors. This plea was reiterated in the following year, and repeated with considerable regularity year after year. It was found that the same need existed in 1929, when it was pointed out that fifteen additional accountants or assistants would be necessary to permit of a biennial field audit of all companies.

In the reports for 1922, 1924, 1928 and 1929 the request was made for additional bus inspectors, but up to the end of 1929 only two part-time men were available for this important duty outside of New York City, although the number of buses has been growing by leaps and bounds.

The situation with regard to the accounting force strikingly shows the disparity between the staff and the increasing obligations of the commission. The records indicate that the securities authorized by the Public Service Commission in the years 1921 to 1928 inclusive amounted to nearly two billion dollars. Presumably capital expenditures which are met out of security issues may be looked upon as a rough index of the increase of facilities, increased number of consumers, increased difficulties of financial control and the like. On this basis it would seem reasonable to expect that there should be some

correlation between the growing investment of new capital and the size of the commission's accounting staff. But as a matter of fact, despite the great increase in the investment, the number of accountants, namely forty-six, was one less in the last year of the period than in the first.

Whether it be due to a policy of false economy on the part of the state legislature or to an acquiescent attitude on the part of the commissioners, there is no doubt but that the staff of the commission has not expanded in any way comparable to the expansion of its functions. What is more, in the recommendations for staff increases from year to year it is evident that the commissioners have failed to request the number of new positions which the proper conduct of their work would require. For example last year only one new accountant was requested. When the question was raised as to the additions necessary for the proper handling of the work, the number suggested approximated one hundred. As a consequence the legislature appropriated nearly \$200,000 for the purpose of bringing the staff up to the proper level, entirely apart from the new functions proposed.

One of the most serious consequences of understaffing is the inability of a commission suffering from this evil to attempt more than the most urgent routine work. The fact is that with the hundreds or thousands of complaints, petitions and the like, the commission is bound to become a checking, if not a rubber-stamping, agency. It rarely makes a motion on its own initiative. If one had to do with a more or less static industry there would be no need of considering anything more than the ebb and flow of the currents within one's immediate range of vision. But with the rapid changes in the industry, with the more and more extensive use of the services and commodities supplied by the utilities, with the rapid spread of integrated systems, an organization whose time and staff are largely absorbed by routine work will find itself sooner or later outdistanced by the companies it is called upon to regulate.

Furthermore, if the commission is to do more than consistently to second the motion made in the first instance by the utilities, it is necessary that it should be equipped with sufficient personnel to devote itself over a long period of time to what

may be called the long-run problems of regulation. These involve such matters as rate structures, rate schedules with special reference to the relative charges to the various classes of consumers; improved methods of accounting, proper allocation of charges to the several operating units controlled by holding companies and constructive study of the most disturbing of all utility problems, namely, that of fair value.

Underfinancing is a chronic ailment of public service commissions throughout the country. An inadequate staff is synonymous with routine administration and a surrender of initiative. Indeed, if a commission is not manned by energetic and capable commissioners and is not equipped with an adequate staff, these two conditions alone may easily lead to a virtual breakdown of utility control.

3. *Functions of the Commission.* It is not my intention to comment upon the wide range of functions entrusted to a public service commission, but rather to direct attention to a conflict between two major functions, both of which are of basic importance in the administration of the typical public service act. The first is the protection and defense of the public as its interests are involved in the management of the utilities; and the second is the so-called judicial function. The former represents the motive that led to the enactment of the original legislation. To realize it the commission is granted the power of initiating investigations and proceedings. The latter is imposed on the commission in a number of sections of the typical act. For this purpose, it is instructed to conduct hearings and render judgment. In other words the commission may be at one and the same time public defender or prosecutor and judge. The most critical test to which a commission may be subjected is the measure of its success in harmonizing these two conflicting functions. If the official reports of commissions themselves or the observations of competent witnesses in various states are to be credited, there are but few commissions in the country which meet this test satisfactorily. The judicial function has encroached upon, if it has not practically supplanted, that of public defender.

On its own showing in the recent investigation of the New York commission, the number of formal cases initiated by this agency during the course of eight years totaled only two

hundred and ten. Analysis of these cases indicated that the great majority were of an inconsequential character. Furthermore, it is comparatively rare that in any proceedings do the staff members of the commission appear on the stand as witnesses. The burden of conducting a case is placed on the consumers or their representatives, the corporation counsels of the municipalities. When it is considered how little experience in utility matters these officials have had on the one hand and how expert the representatives of the utility companies are on the other, it is apparent that, to speak familiarly, the cards are stacked against the consuming public. It is true that the commission gives such assistance as it can to the corporation counsels in the preparation of cases, but as the evidence shows this is limited on account of the great pressure of work with which the staff is burdened. The result is that the cities which wish to seriously prosecute a rate case are obliged to call in outside experts. According to the record they are loath to do this because of the great expense. The conclusion cannot be disputed that the commission has all but defaulted in performing the function of defending the public as a prosecuting agency.

The feasibility and propriety of doing this is being demonstrated at the present moment in the conduct of the New York Telephone case. Here the counsel of the commission is carrying on the prosecution as a true public defender. This policy may be explained in part by the fact that this is a state-wide case. It should be remembered, however, that in view of recent mergers and consolidations in the various utilities the number of localized operating companies is rapidly approaching the point of zero. Something more than local action has therefore become practically mandatory. If the commission fails to take the initiative and to prosecute cases for the public, it will be necessary to set up another expert agency for this specific purpose.¹ In reviewing commission regulation over

¹ In recognition of this situation the Maryland law provides for the appointment of a People's Counsel by the Governor. He has the power of initiating investigations and also of representing consumers or municipalities at their request. According to reports the incumbents of the office have succeeded in working harmoniously with the commission; they have also avoided the temptation of using the office to bait the corporations. It is an interesting experiment and has attracted widespread attention.

the period of nearly twenty-five years, we must list this conflict of functions as one of the major unsolved problems. It challenges attention as never before because, with the passing of local plants and localized operations, the defense of the public interests must be conducted on an "area-wide", if not a state-wide, basis. Consolidations also bring in their trail highly complex operating, accounting and financial conditions. To unravel these, as is necessary in a rate proceeding, demands a high degree of expertness and a great amount of information, such as only a permanent body could command without excessive expense. As never before, therefore, the use of initiative and a readiness to provide the requisite staff for positively representing the public will measure the efficiency of the regulatory commission. This practically means a revolutionary change of emphasis in the conduct of the typical commission.

In conclusion it may be pointed out again that the characteristic inertia of the representative commission in the use of initiative is doubtless due in considerable part to the incongruity involved in the situation itself. The same agency can hardly be expected to prosecute and judge. It may well be that this anomaly can be finally eliminated only by separating these functions through the creation of a kind of commerce court for the trial of contested issues and an administrative and prosecuting agency upon which would be imposed the duty of protecting the public interest. But it cannot be said that the possibilities of combining the two functions have been fully explored, although it must be granted that certain exceptional commissions have been more active in the attempt to harmonize them than others.

4. *The Problem of Fair Value.* In view of the large amount of fixed capital employed in the operation of the utilities, particularly the electric utility, the problem of a fair return on a fair value looms large in the determination of rates, which must be looked upon as one of the chief functions of the public service commission. Indeed the thesis might be defended that the determination of the value of the investments is the first step in rate regulation, but it is a step which most commissions—with the exception of three or four commissions, so far as is known to the speaker—are unable to take

today because the decisions of the Supreme Court have opened the door to a wide and disconcerting range of possible interpretations of how value is to be defined.

In the early years of the New York State commission, Chairman Stevens called attention to the fact that competent engineers differed by from one to two hundred per cent in the estimates set upon the value of the same property. This was before the day of price inflation, which has of course greatly complicated the problem. Under the court decisions we not only have uncertainty as to the relative importance of original investment and reproduction cost, but there has also developed a new technique of valuation in which ingenuity and imagination play a not insignificant rôle. The best evidence of this is found in the effort made by the New York Telephone Company to capitalize what was termed "the inexperience factor". According to this ingenious proposal an estimate was made of the difference in the cost of producing telephone instruments and equipment on the one hand by the Western Electric Company, a subsidiary of the American Telephone and Telegraph Company, and on the other by an imaginary inexperienced manufacturing concern. The estimated difference was \$17,000,000. Although the item was stricken out by the statutory court, it goes to show that the term "reproduction cost" may become, if it has not already become, a very unstable basis for arriving at a figure that can be used in a more or less precise calculation.

If a commission does not have, as most of them admittedly do not, a rate base for the utilities coming under their jurisdiction, the only practical method of passing upon this important item in determining rates is that of guess and negotiation. In such negotiations a well-managed commission will have the book cost and the companies a more or less definite conception of the reproduction cost. How widely these may vary is proved by the statement of one of the leading officials in a New York electrical corporation who insisted that the company's appraisal called for a return upon \$110,000,000 in spite of the admitted fact that the actual investment was not in excess of \$30,000,000. He emphatically deprecated the importance of book cost in determining fair value on the ground that the Supreme Court had prescribed reproduction

cost as the basis of fixing value. It is difficult to see how the chasm between the body of facts available to the commission and the body of facts and estimates used by the executives can be bridged except through an expensive and time-consuming rate case. What is more, as soon as the fair value is determined for a given property it becomes obsolete in a brief space of time. The supervision of rates is a current function of the regulatory agency. How it can be currently handled with the rate base subject to normal fluctuations and reinterpretations is a problem of no mean proportions.

The importance of bringing order out of this chaos is evident when one considers the results of the investigation of the rate of return upon book costs in the electrical industry as made for the first time in 1928 by the New York commission. Armed only with book-cost data and the methods of negotiation, the commission nevertheless found it possible to bring about approximately one hundred rate reductions. If it had been armed with valuations that carried more weight with the utility companies than book costs, it may reasonably be assumed that more general or more sweeping reductions might have been secured. The commission necessarily had to accept what it could get, while the companies were in a position to give no more than they wished. Negotiations under such circumstances are at best an unsatisfactory procedure.

The logic of regulation calls for a currently valid rate base of all utility properties under whatever methods may be prescribed by the authority of the Supreme Court. Consistently with this provision it was recommended by the commission investigating the Public Service Commissions Law in New York State that a state-wide valuation should be made mandatory upon the Public Service Commission and sufficient appropriations provided for the carrying out of such a valuation. This mandatory provision was in my opinion a matter of supererogation, because there can be no sound judgment upon the reasonableness and fairness of rates without such information. To pass such judgment from year to year is the very essence of utility regulation. The provision of funds should suffice.

In view of the widespread attacks upon the valuation decisions of the Supreme Court, a word of dissent may not be

out of order. It should be pointed out that public utility law is in the process of becoming. It is one of the newest branches of public law. How far we are from a crystallization of opinion upon the determination of fair value may be assumed from the variety of opinion expressed on this subject before the New York investigating commission, particularly in relation to the so-called Bauer plan. There was hardly any support given by experts to the prudent investment theory which was worked out by Dr. Bauer and later embodied in a bill formulated by the minority members of the commission. When specialists disagree and public opinion is lacking, it can hardly be expected that the Supreme Court will take an advanced position in which it defines the several factors and specifies the weight to be attached to each in the determination of values.

I would personally express the hope that the publicity given to the differences between the so-called majority and minority reports of the New York investigating commission may concentrate attention upon this central problem of utility control. If there is once agreement on this subject among leading public utility economists and constitutional lawyers as well as some general understanding in the public at large, it may be confidently anticipated that the Supreme Court will adopt a more definite and workable formula for the guidance of commissions. Until this is done the task still remains for the alert public service commission to arrive at acceptable and valid values even though in a fumbling way and by measures that entail a great amount of expense.

5. *Holding Companies.* The rapid expansion of the holding companies marks the passing of the local operator with his slogan of public service and close contact with the consuming public. It means further the practical domination of the utility field by the financier with his eye directed primarily at profits. The consequences of this shift of control have been manifold. It has brought in its wake both advantages and disadvantages. The chief advantage is the rapid spread of interconnections which at the the present rate will soon join together the whole of the country in one all-embracing grid-iron system. In this system state lines will be as completely ignored as they are in the present network of the railroads.

Other advantages are improved and more economical methods of financing, of purchasing, of construction of plants, and marked improvement in the processes of production, transmission and even distribution. For these advances great credit is due the holding companies and it is but proper that their services should receive an appropriate reward.

The great disadvantage is that the utilities have become almost over night the shuttlecock of speculation. Operating outside the area of public regulation and control, the holding companies have served as a device for flooding the market with a tidal wave of promissory notes in the form of stock certificates which were issued on the security of operating company stock. Such practices jeopardize the financial security of this industry that is so essential to the well-being and prosperity of the country. In the words of the editor of the *Electrical World*: "The bankers made handsome returns out of electrical public utility flotations and while the going was good it was a question sometimes whether ethics and the wonted caution of bankers were not more honored in the breach than in the observance."

Not alone has financial security been jeopardized, but the effort to increase earnings because of the speculative capitalization of past and prospective future earnings has brought about the temptation to exploit the public. This statement is made despite the fact that rate reductions, particularly for electricity, have taken place very generally up and down the country. Whether these reductions were adequate or not in view of the savings which have resulted from more successful methods is unknown either to the companies themselves or to the regulating commission. The necessity of earning dividends on huge stock issues is a further temptation to utilize the indefiniteness of the Supreme Court decisions for the purpose of inflating values. Without reference to who the actual owner may be, the theory of fair return upon a fair value must apply at all times and under all circumstances. How this principle can be harmonized with the wave of speculation that has swept over the industry it is impossible to explain.

The evidence before the New York investigating commission practically proves that holding companies both directly and indirectly influence, if they do not dominate, the management

of operating companies. In one case, for instance, it was shown that by a mere vote of the executive committee of the holding company the operating company was arbitrarily required to pay five per cent of its gross revenues to the holding company and by a second vote passed some time later the levy was discontinued. Stock ownership, interlocking directorates, concentration of voting stock in the hands of an inside group and similar devices give the holding companies a strangle hold which runs directly counter to the principle of regulation.

It seems unnecessary to argue the obligation both of the state legislatures and of Congress to place holding companies under effective public control. If they do not, in the course of time public control may become to a considerable extent a farce. Remembering the railroads, the public service commissioners at their annual meeting last summer went on record to the effect that their representative should oppose the control of holding companies in the electrical field along the lines proposed by Senator Couzens. This position indicates a lack of appreciation of what the Germans call *Realpolitik*. As President Roosevelt indicated in 1907, the authority of the agencies of control must be coextensive with those agencies which are being controlled. It is folly in this day to shut one's eyes to the fact that holding companies take no cognizance of state lines.¹ But even though there be no interconnections, the operation of foreign holding companies within one state or another is rapidly spreading. If these are facts, the problem has already become interstate in its scope and its solution can only come through the medium of an interstate agency.

Among the necessary amendments to the Public Service Commissions Law there is unquestionably none which compares in importance with the extension of the authority of the state commissions over holding companies. Such legislation should be broad enough to make the contracts between holding

¹ The formation of a holding corporation was recently announced which has a network of interconnections extending from Lake Michigan to North Carolina. The United Gas & Improvement Company and affiliated corporations hold considerable if not controlling interests in companies operating from Connecticut in the northeast to Arkansas in the southwest, excepting only Maryland, the Carolinas and Florida.

companies and their constituent units, as well as between operating companies and other affiliates under the holding company system, subject to the commission's approval and to make the records of such transactions subject to the commission's audit.

It is highly desirable that states should take advantage of the compact clause of the federal constitution in order to coöperate in matters of mutual concern. In case of the failure of the compact method, federal control will inevitably come about. It is to be hoped that it will be along the lines of the Couzens Bill which provides for the creation of joint state boards when an interstate problem arises and for action by the Federal Commission only when the joint board fails to agree. By such decentralization local participation and interest will be conserved and the danger of remote and bureaucratic domination all but eliminated.

Conclusion

The utilities have now entered upon a new era. All cities and towns of any size are now supplied with electricity and extensions are being rapidly made into rural areas. In our industrial plants machinery is driven by electricity more commonly than by any other form of power. The number of states that are interconnected by one and the same transmission system is rapidly increasing. Interconnections for the distribution of gas are becoming more and more common. Trans-continental bus lines are established and operating successfully. Privately owned water companies are being bought up and consolidated under a limited number of holding organizations. Withal the utilities constitute one of the first four or five major industries from the point of view of investment and annual earnings. These evidences may suffice to indicate that a new epoch is at hand. By the same token we must enter upon a new epoch of public control. The guiding principle of a fair return upon a fair value must be clarified and applied in all of its ramifications and wherever it may lead. But above all else the public service commissioners must enter upon their task with a new spirit and outlook and must be given sufficiently generous support by the several legislatures to provide personnel adequate and competent to administer the law.

THE STATE ABDICATES: UTILITIES GOVERN THEMSELVES

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NO nation can live permanently if any of its citizens or subjects, or any organized group of its citizens or subjects, is stronger than the state. This dictum conforms to the legal maxim that no man is fit to be judge in his own case and to Lincoln's statement that no man is fit to have unrestrained power over another. We are always in an emergency in America. Emergency action is always ill-considered and usually temporary.

The truth is that in all countries, at all times, the dominant economic group gives shape to governmental policies and accepted ethical codes. But this fact has taken on a new and more sinister significance in America today than ever before. The world never before saw a race so virile in body and mind thrown into contact with so great an extent and variety of natural resources and so far removed by nature from danger of outside interference. Furthermore, the race was not restrained by the age-old traditions of European nations. The people really believed that the natural resources were unlimited and inexhaustible. Therefore, when one appropriated and even wasted these resources he wronged no man, present or future. What he did, any other man could do. The economic doctrines of individualism, free competition and free contract were accepted as natural laws, and worshiped as a religion. The closest parallel we have of an economic doctrine becoming virtually a religion is in Soviet Russia today. Again, the pioneer population was chiefly agricultural, and was virtually equal in social, economic and educational power. The population was politically speaking free and every man was left to look after himself. The Jeffersonian doctrine of the less government in business the better prevailed. Capital was but little developed—credit less so. Transportation and credit

were largely local. Such savings as were made went largely into the business that created them. Corporations were few. They were created mostly by special legislative act; in theory their capitalization in both stock and bonds was strictly limited by the state. Such were the theories, the material, social and political backgrounds of America until after the Civil War.

To understand the transformation that has since taken place and its significance, we must look a little closer at some of these doctrines, particularly at that of competition.

The economic doctrine of competition, as formulated by Ricardo more than one hundred years ago, still dominates the popular, the legislative and the judicial mind, but has been deserted entirely by business practice. That doctrine rested ultimately on natural law and involved certain fundamental assumptions which have no rational affiliation with a capitalistic age dominated by large, fixed, specialized capital, with world-wide markets, and all resting on an ocean of credit.

Briefly stated, this highly individualistic doctrine assumed, that, when two or more producers seek the same market, prices will be cut until a point is reached at which the most efficient sells at a profit, all others at a loss. It is further assumed that, thereupon, all who cannot sell at a profit can and will transfer, without serious loss, their capital and labor to more promising fields. If prices are then raised, capital and labor will return and again reduce prices. In other words, both capital and labor are entirely mobile. Furthermore, so far as the assumptions are true, all prices are based on costs to the most efficient, and all reduced to a uniformity. All profits are leveled to a uniformity and to a minimum, based on costs to the most efficient plus the customary minimum profit, until only the most efficient remain: then you have monopoly. Every tyro now knows that in an age of fixed, specialized capital, serving world markets, and resting on credit, none of these assumptions is true. No company with billions, or even millions, of fixed capital stops selling goods because prices fall below cost. One of the leading retail merchants recently testified before a congressional committee that a skillful buyer could buy most of his goods below cost. Instead of ceasing to produce, under the circumstances, the producers, theory or no theory, law or no law, simply combine to limit output and to adapt the supply.

to the demand at a profitable price. But such a combination, to survive, must take in a great lot of inefficient producers to prevent outside price-cutting. The result is that prices, instead of being based on cost to the most efficient, are based on cost to the less efficient, and the consumer is charged what the traffic will bear. Another result is a constant overproducing capacity. It is probable that from seventy to eighty per cent of the American manufacturing capacity could supply the demand today at any price that would yield a profit on the investment. Another result is the alternation of boom and depression, known as the business cycle. The result of depression is wholesale unemployment. The latter gives us a side glance on the mobility of labor, and on the general slowness of competition. Perhaps the English coal-mining situation throws the most light on this problem.

As overinvestment in industrial and commercial enterprises grows, the persons engaged in such fields bring more and more pressure on the government for legislation and administrative action to enable them to hold and enlarge their opportunities. It is not too much to say that for half a century now these classes have dominated the government, not in the interests of a permanent and worthy civilization, but to their own financial advantage and to the endangerment of civilization. So far as America today is not planless, the plans are all in the interest of special groups and not for the public welfare. England and America, being the first capitalistic nations to attain stable governments, were able to press this urbanization and commercialization with apparent safety so long as wealth and population were increasing at a phenomenal rate and vast overseas territory and populations could be exploited. When Germany undertook to emulate them, war was the result. The collapse of England's foreign trade showed the results of such a system. On the other hand, we, being virtually untouched by the war in man-power and wealth, found an added opportunity to expand the system. But apparently the rest of the world is about exhausted and we find ourselves at present in depression, with overinvestment in manufacturing capacity, considerable unemployment, falling prices, foreign trade dropping off, and general social unrest increasing. We go at the problem by true American emergency methods, under control

of the dominant element. Their cry is, raise the tariff. They attempt to save themselves at the expense of the rest of the world. They prescribe the worst possible remedy, sure to increase the hostility of all other peoples against us, to decrease the foreign trade on which we are now dependent for profits on our overexpanded productive investment, and to cause retaliatory action on the part of foreign nations. This element has not yet learned the primary lesson that impoverished people are not good customers and that in the long run a nation cannot sell goods to foreigners unless it buys foreign goods.

If exploitation of natural resources was to go on after the Civil War on a large scale, larger corporations were necessary, and the corporation laws were relaxed. Up to 1889, the state determined the powers and duties of corporations, and prevented the growth of combinations and even large-scale production. But beginning in New Jersey in 1889, powers were granted to one corporation to own shares in another, and, what was much more important, the incorporators were allowed to determine in their charters their own powers. Until that time, corporations were organized largely by men who owned the controlling shares and managed the companies. They had grown up in the business and knew it from beginning to end. The era of combinations, trusts and mammoth corporations then began. They were promoted by outsiders, financed profitably by bankers, and the uninitiated public was appealed to for funds. The stockholders lost all semblance of control over the management. Not only was the management separated from the ownership, with all the evils of absentee ownership, but the directors, under the new form of charter, were allowed to determine not only the policy of the corporation, and the distributive shares of the income, but even the values of the different shares in the ownership. The state thus abdicated its part in the control over corporate affairs. This is what Berle has so aptly called the new form of feudalism.

The answer of the voters, justly afraid of unjust exploitation and monopoly extortion, was a mass of legislation meant to enforce competition. We got the federal Sherman Anti-Trust Law of 1890 and the Federal Trade Commission Act and the Clayton Act, 1914, and anti-trust acts in most of the states. If the public wanted the benefits of large-scale production, all

these acts were a mistake from the beginning. For they rested on the profound fallacy (explained above) that competition in the Ricardian sense is possible with large, fixed capital. The public then had its choice of doing without the benefits of large-scale production, of recognizing monopoly and attempting to regulate it, or of submitting to unregulated private monopoly. But the public was too ignorant to recognize the facts, and undertook to compel competition. That effort has proved futile. Incidentally the United States alone of the great capitalistic nations has attempted to enforce competition. Interested parties found it easier to control the government, including the Supreme Court, and caused the acts to become a dead letter rather than repeal them. Hence the rule of reason and the putting to sleep of the Federal Trade Commission. At least, we do not have competition and we do have monopoly, through single large corporations, through pools, through community of interest, through cartels, and through trade associations. The anti-trust acts, state and federal, have not enforced competition, prevented combinations, or protected the consumer.

Let us turn now directly to the public utilities. The great American public and the small business world (carefully coached on the point by propaganda of interested parties) still believe in competition. When in any field it breaks down and results in intolerable conditions, according to true American emergency action, the legislature declares the industry in question an exception to the general rule and undertakes to fix prices directly by public authority. Regulation here is supposed to be a substitute for competition. But in the theory of competition fair prices—minimum prices based on cost to the most efficient—are fixed automatically, and no public action is necessary. Natural forces furnish the standard and achieve the results without the aid of man. But there is positively no standard of fair prices for the legislature or a commission to take as a measuring rod of fair prices. For no authority, public or private, has ever made significant cost studies as to the general costs in these industries or in different classes of service. Existing prices must always be compared with hypothetical prices. Still further, the apportionment of prices to different classes of consumers is purely a matter of social policy, resting

neither on law nor on statistics, but on what portion of consumers it is socially advantageous to favor. After the total operating outlay of the whole enterprise has been met, how much shall be collected for capital return and how it shall be apportioned to different classes of consumers is purely a matter of social policy, a legislative matter of determining property rights and corporate rights, and no proper business of the courts. From what has already been said, it ought to be plain that the distinction between public utilities and other industries is simply a legal fiction with no economic basis whatever. Wherever competition, in an economic sense, fails to work, there is the same need for regulation as in public utilities. Competition actually fails to work in the case of most manufactured goods that enter into wide markets.

When regulation was forced on the public utilities, in the face of tremendous opposition, it was customary for the promoters to water stock to the full extent of their ability, to unload the stock at any price whatever, within any time that they were willing to wait. It was then common for promoters to sell enough bonds to construct the property, pay themselves large construction and financing profits, and keep stock which cost them nothing. If the country grew up to the enterprise rapidly enough, they made large profits. If the enterprise failed, they had already made large profits and the loss fell on the bondholders. This was the standard set by the utilities for themselves. When regulation tightened up on formal stock-watering, the interests involved, yielding no whit of their desires or aims, set about to accomplish the same end by other means. First, by their influence on government, they induced the courts by tortuous reasoning to reverse their ruling to the effect that the fixing of a rate is a legislative function, to make it in fact a judicial function. No one cares, in the least, who has a right originally to determine a rate, so long as he has a right to prevent its going into effect. The right to annul a rate is, economically, a right to fix a rate. No legal quibble or judicial legerdemain can change the fact.

The dragging into this field of the fourteenth and fifteenth amendments to the Constitution destroyed, once for all, the power of regulation. The fifth amendment was meant to prevent arbitrary action. It was aimed at absolute kings and

despots and was not meant to prevent expert opinion on complex economic facts or sound public policy. The fourteenth amendment was enacted to prevent reënslavement of the blacks and not to furnish a code for the government of vast aggregations of capital. The sole occasion for regulation was to prevent the speculative gains permitted from unregulated property. The doctrine of the court rests on the law of eminent domain, the expropriating of the title and the use of property. When the state fixes a rate it takes neither the title nor the use, but simply a part of what would be the speculative gains if there were no regulation. The aim is simply to fix a fair price when competition or natural forces fail to do so. In that sense regulation is meant to reduce what, without regulation, would be the value, based on earnings. When in *Smyth v. Ames*, 1898, the Supreme Court said that the company is entitled to "a fair return on the fair value of the property", it made all regulation impossible. The phrase fair value has never been defined by the court or by any one else. It cannot be defined. The phrase is not a legal phrase. The word "fair" belongs not in law or in economics. It is an ethical term. The word "value" has a well defined meaning in economics. The value of an industrial good is what it will exchange for and is determined primarily by its earnings, real and prospective. But the earnings of a utility depend on the rates. Therefore if a utility had a value it could not be determined until the rates were known. But value is determined on an open and unrestricted market for free and unrestricted goods. But there is no market in the sense here used for utilities, and utilities are restricted goods. Hence, there is no value. Mill truly said that where prices are not fixed by competition they are assignable to no fixed law. But we are dealing here with a field from which competition is excluded by law. We are, in fact, dealing with what the economist calls monopoly values. But by definition monopoly values are based on what the traffic will bear: that is, on what the public will pay rather than do without the service.

The object of the monopolist is always to charge what will give him the largest net profit. So far as the economist discusses what he calls monopoly value, he concerns himself with the complex fears and social restraints and psychological in-

fluences which guide the legally unrestrained monopolist in fixing his price to get the largest profit under the existing circumstances. These influences range all the way from the fear of assassination and social ostracism to the fear of expropriation or government regulation. Such considerations do not concern us here. But in this field with which we are dealing, prices are fixed by governmental fiat with the sole purpose of preventing the utility from charging what the traffic will bear. The moment the state takes an industry out of the realm of unrestricted property, calls it a public utility and declares it subject to regulation, that property ceases to have value in the economic sense of that word. The law has created a new category of property, a new phenomenon has appeared in the economic world. The property is then subject to a multitude of restrictions wholly inconsistent with and contradictory to the idea of value. Value implies and requires competition, a market and free contract, all of which are lacking from the utility field.

To introduce the idea of value or the word value into the field of regulation is to confuse ideas and to destroy the possibility of any regulation. To add any qualifying words such as "fair value", "reasonable value", "actual value", or "value for rate-making purposes", is simply to add to the confusion, not to clarify it.

The medieval schoolmen put in their time discussing how many angels could dance on the point of a needle. They are well worth reading for their intellectual acumen and logical hairsplitting. So much cannot be said for the court's discussions of value. They are fully as hypothetical, but since they fail to define their terms, logic fails them. Consequently the reader lands in a morass of confusion and contradictions. He gets neither enlightenment nor pleasure, only weariness and disgust. The result of this confusion is that we have legal monopoly without regulation. The only beneficent result of this expensive and long-drawn-out attempt at regulation is considerable investigation and some degree of publicity. This, doubtless, has a restraining influence on the unregulated monopolists. They do fear expropriation and may even have some fear that an aroused public opinion may introduce effective regulation by entirely new methods.

To show how we have come to the present impasse, a brief review of government activity in this field since the case of *Smyth v. Ames* will be useful. The courts speak of finding value just as one would speak of finding a lost dog, as if value were a definite, fixed thing. As already indicated, value is not a fixed entity, but an opinion or judgment, fluctuating from moment to moment and determined only under circumstances and conditions that have been formally excluded by law from the whole field of public utilities.

When the court said, in 1898, that rates must be based on value, it mentioned several things that must be considered in arriving at value, but assigned no specific weights to these things and said that other things not named here might possibly be considered. Some of the things named were irrelevant to anything the court said then or has said since; some were virtually contradictory and mutually exclusive; several have since been quietly ignored by the court itself. The two that have received the most notice since are "original cost" and "present cost". The latter has since been transformed into "cost of reproduction". A determination of any value on any basis was wholly unnecessary for the decision of the case. All of the railroads of the state were involved in the case. Each of them had cost more than the par value of the bonds. The rates declared void would not pay operating expenses and interest on the bonds. On but two of the roads would the rates pay operating expenses, and that but for a small part of the time considered by the court. Therefore, the famous reference to a "fair return on the fair value" is aside from the point and logically must be regarded as pure dictum. It is true that W. J. Bryan, special counsel for the state, urged upon the court the use of the cost of reproduction in the sense in which that phrase is used today, but there is no indication in the decision itself that the court paid the slightest attention to this argument. The only reference in the decision to cost of reproduction comes after the passages declaring the statute unconstitutional and consists of citations, without comment, from a report made to the Transportation Board by its employees seven years before this case was decided. It may be doubted whether the court, in the whole proceeding, gave any thought to cost of reproduction.

It is not impossible that in its loose phrase "present cost" it merely meant to distinguish from the cost of the original roads the additions and betterments added since the roads were originally constructed. For there is no indication in the decision itself that the court gave any consideration to the change in general prices. It was not necessary to do so to arrive at the conclusion that the statute was unconstitutional. The interested parties, however, at once seized upon the phrase "present value", and turned it into "cost of reproduction". Thus was regulation transferred from the realm of fact to one of fancy and opinion. Such properties are never reproduced. Nobody proposes to reproduce them. It would be a mere waste. In case a miracle removed a large utility, and a new one to render the service were considered necessary, no one would think of reproducing an identical property in the same locality. An improved, more modern and better located property would naturally be produced under entirely different circumstances, and, because of improvements in the arts, at entirely different cost, even had there been no change in the general price level. When we enter upon an estimated cost of reproduction of a large property, such as the Pennsylvania Railroad, there is no possible rational basis for proceeding. It is entirely outside the realm of human experience. The whole procedure must be based upon assumptions as to conditions, prices and time required. The hypotheses are so far removed from human experience that, within the widest limits, one set of assumptions is as rational as another. How long would it take to reproduce the Pennsylvania Railroad under one contract, by one impulse, as the Interstate Commerce Commission expresses it? What effect would such a proposition have on the price of steel or of labor? What assumptions should be made as to transportation of material and transportation facilities? Or as to clearing the right of way? Are parts of the road when completed to be put into operation and begin to earn, or must we wait until the whole system is completed? If parts are to be operated, what parts and how long?

When the Western Pacific Railroad was built, no railroad crossed its right of way. It was necessary for the company to spend over a million dollars in building wagon roads and to haul the construction material hundreds of miles by wagons.

Today seven railroads cross the right of way and can deliver material at various points on the line. In estimating the cost of reproduction, are we to assume the original conditions or the present conditions with all the modern machinery and methods? The answer to this conundrum is that it depends entirely on the results one wishes to obtain. For, as already said, one set of assumptions, within wide limits, is as rational as another. All that can be said is that in practice the utilities reach a result that will equal or more than equal their capitalization and arrive at a sum as large as or larger than the company could earn a fair return upon in the absence of any pretense of regulation. Having thoroughly fortified such sum behind constitutional barriers, they then announce to the court out of the pure kindness of their hearts a willingness to accept a smaller sum as a rate base or value. But they always ask for more than their capitalization and a sum larger than the traffic will pay a return upon at any rate they hope to be able to induce the court to fix as a fair rate of return. Thus does the state abdicate and make the utilities judges in their own cases.

As the court has denied one so-called element of value after another—such as good will, franchise value, and the like—the utilities have simply invented new items and valued them on a purely hypothetical basis. Sometimes, when the courts arbitrarily wish to add to the total and excluded items are again urged upon them, the courts include the item previously excluded and solemnly rechristen it, as when, recently, the franchises of the Baltimore Street Car Companies were valued as easements. For thirty years now the chief energies of the utilities have been applied to the invention or discovery of new items or elements of value such as conceiving the idea of a street-car system in the National Capitol in the twentieth century, for which they claimed a value of two million dollars, or training employees who do not exist, for a utility that does not exist. Does the state in a rate case propose to take the employees of the company? How far removed this is from the idea of condemnation or expropriation on which courts base the necessity of valuing! No one proposes in a rate case to expropriate the employees that exist, to say nothing of non-existent, hypothetical employees that no human being wants to beget. To such extent has folly carried us by pursuing fictions

and deserting facts. It must be remembered that the consumers pay all the expenses of these so-called valuation proceedings, often extending over ten or more years and running into many millions of dollars in a single case. Such expenses are charged to operation and the company is entitled to a fair return on the value in addition.

Likewise, the expenses of propaganda to convince the public that this is regulation and in the public interest, and even the political contributions to secure newspaper support and judges and commissions that are favorable to the utilities and to corrupt teachers are all charged up to operation. That the consumers ought to pay the legitimate expenses of the companies goes without saying, but this has no relation to valuation or to the rate base. When general prices go up, expenses of operation necessarily also go up, but that has no relation to the contributions or sacrifices the owners make in serving the public. The rates should be such as to recoup the company for expenses whether prices are high or low, but this has nothing whatever to do with valuation of existing property. So long as valuation is a prime element in rate-fixing, the industry will literally govern itself in its own interest, not that of the public. When the court decreed valuation, the state lost its influence and control over rates. In other words it abdicated. But wholly apart from the question of valuation, other forces have taken the industries entirely out from under regulation and made the pretense of regulation a farce. Certain corporate forms of ownership and methods of management enable the companies to load their expense, over and above the items already mentioned, to an extent to support rates as high as the traffic will bear and thus to escape entirely from regulation so far as the general level of rates is concerned.

The electric industry above all others, under present theories of valuation, lends itself to inflation of values, because of the rapid changes in the arts; this is particularly true of the generating plants. When a holding company buys up a multitude of small plants and establishes large central generating plants, a very large part of the old investment becomes useless. But under the theories of valuing identical property on the principle of cost of reproduction it is still carried on the books nominally as stand-by equipment. The public then pays on

the old and also the new investment as if the old investment were in full use and the plants depended on it for their life. Hence the company, not the public, gets all the gains from progress. With the possibility of wide transmission, consolidation was both inevitable and necessary. Here, as elsewhere, it was not a question of large-scale production or small-scale production, but of how the gains from the economies of large-scale production ought to be distributed. If regulation has any justification, in economics or ethics, here was its greatest opportunity to exercise its power in establishing a sound public policy and a just distribution of benefits from what Mill calls the progress of the arts. A generation ago, just about the time electricity became practicable, the corporation laws were relaxed to allow one corporation to hold shares in another. Groups of financiers and promoters began to buy up controlling interests in different companies. These companies are under state charters, and so far subject only to state regulation or control. But no sooner did this movement begin than the promoters began not only to own and control under one management large numbers of companies, but they organized and owned auxiliary finance companies, investment companies, engineering companies, management companies, service companies and holding companies piled upon top of holding companies as high as the Eiffel Tower. As a result, these groups operating nationally and many of them not in law utility companies, are entirely exempt from regulation. Each state jurisdiction is limited to property in its territory. Only the local operating companies in a state are nominally subject to regulation by that state. But a holding company spread all over the country has complete control over the affairs of all the companies owned. Through promotion contracts, financing contracts, construction contracts, service contracts, inter-buying and selling contracts, management contracts, material-purchasing contracts and the like, they can run up the expenses of any local company to any limit they wish. For they are always contracting with themselves for their own benefit.

The Power Trust investigation has brought out the fact that some of these contracts have called for payments by the local companies four times as large as the expense of executing the contracts. There is literally no limit to the degree of elasticity

of such contracts. Expenses can be raised within practicable limits as high as the managers wish. What is going on has been concealed by the fact on the one hand, that most of these contracts are never known to the public and, on the other hand, by the fact of the enormous progress in the arts, which has resulted in fabulous earnings for the owners with substantially stable prices to the consumers. The question arises here whether all the gains from the progress of society should go to a handful of owners and whether the mass of the people should get no advantage from the advance of science. One is reminded of the late James J. Hill's speech in New York in 1911 on the generosity of the railroads in reducing rates. He showed how many billions of dollars more the public would have paid in rates if they had paid on the traffic moving in 1911 the same rates they had paid twenty years before. The clear assumption was that the roads were entitled, legally and morally, to deprive the public of railroad service or make them pay an amount that would leave them no better off than if railroads had never been invented. He might just as well have compared the cost of transportation by ox carts.

In this age of abundant capital and universal engineering knowledge, the tacit assumption that the private owners of a fundamental necessity performing a function of the sovereign state by license—a function which even our bewildered Supreme Court declares the state has both the legal right and duty of performing directly if it does not find it more advantageous to authorize a private agent to perform it—should be able to put the public under penalty of being deprived entirely of the function seems carrying the idea of individualism and individual property rights a little too far. We had railroads before Mr. Hill was born. We have them since his death, and, probably, should have had about the same railroads we now have if he had never lived.

The conclusion of my study is that:

1. Regulation, as at present practiced, is a dead letter and a farce.
2. There can be no effective regulation so long as valuation, by any method, is made the basis of regulation.
3. Holding companies must be controlled before regulation

becomes possible. This will necessitate compulsory national incorporation, and require that all the property controlled by one group be owned directly by one corporation.

4. The corporate structure must be greatly simplified and the kinds of securities strictly limited.

5. The emphasis ought to be thrown on the original organization and capitalization and on the accounting.

6. The court must be deprived of its power to declare void legislative acts and administrative regulatory orders on the mere ground that they are unreasonable, or confiscatory.

7. The state should abandon all idea of determining the general level of rates, and concern itself, so far as rates are concerned, with discrimination only.

We are already in practice bearing rates based on what the traffic will bear. We attempt to regulate because the industries are monopolistic. The only safe method of dealing with monopoly profits is not by fixing rates but by direct profits taxes in every field of monopoly. Our present methods in this field are as futile as trying to enforce competition in the industrial field by anti-trust acts.

If the foregoing suggestions seem radical or impracticable, I answer that everything tried so far has failed, and that serious conditions require radical treatment and fundamental remedies. At present, the general public takes little or no interest in this matter. But should we have a long business depression they will wake up, and all sorts of remedies more radical and dangerous than any proposed here are likely to be tried. We may look for the proposition for the election of all federal judges, the recall of decisions, the recall of judges, the annulling of judicial decisions by direct vote of Congress, and many more like experiments. If the civilization survives such foolish measures as are likely to be tried, let us hope that out of the welter and the chaos will come some rational and workable method of dealing with these industries so vital to our present civilization.

DISCUSSION: STATE REGULATION ¹

THE CHAIRMAN: ² We are prepared to welcome remarks by those who would like to take part in the informal discussion of the morning's papers. It has been suggested to me that the editor of *The Portland Evening News* may be present, Mr. Ernest Gruening. We should be very glad to hear from him if he is here.

MR. ERNEST GRUENING (Editor, *The Portland Evening News*, Portland, Maine): Mr. Chairman, this is an unexpected call. I have been tremendously interested by the presentation of first one side of the question by Mr. Spurr, then the other by Professor Gray, and then the first again by Mr. Prendergast.

One of the things which we in Maine have come in contact with, and which perhaps is of interest because of my personal experience with it, is the large unregulated sphere of activity of the utilities outside the utility business. Electric utilities have entered into politics, for instance, into education, into various businesses other than power, and have purchased control of newspapers.

Recently we had a campaign which culminated in a referendum as to whether hydroelectric power should be exported from Maine. The companies have admitted an expenditure of some \$197,000 in the course of this campaign to influence public opinion. This expenditure, being limited to the period from about the end of March to the date of the referendum on September 9, does not include the expenses of the four or five years previous. The expenses of the four or five years previous came admittedly out of the Maine consumer.

This question having been raised and being somewhat detrimental to the success of the power companies' campaign, it developed that the expenses of the referendum campaign, of which \$197,000 have been admitted, came from the sale of some Texas securities held by one of the holding companies which controls the Maine companies. This leads us then to an extraordinarily complex and interesting question of accounting.

It seems that the holding company which controls the various Maine operating companies and is supposedly functioning only in the three states of Maine, New Hampshire and Vermont, nevertheless was able to purchase in Texas the stock of a related holding company at a figure very much lower than the stock quotations on

¹ An abstract of the discussion which followed the addresses of Messrs. Shaw, Mosher, Spurr, Prendergast and Gray at the first session of the Semi-Annual Meeting of the Academy of Political Science, April 11, 1930.

² Dr. Albert Shaw.

the market ever showed, to sell at a figure four times higher, and to have this sum transferred from the Texas company into Maine for the purpose of swinging an election.

I mention this merely in passing to show that this whole question of regulation and control and rate-making introduces factors that are outside the mere question of production, distribution and sale of hydroelectric energy, or electric energy that is not hydroelectric. It suggests very obviously the need of a far greater control than can possibly be secured through the local public utilities commission, which of course has no power to go beyond the confines of the state.

When some of the speakers refer to the politicians and imply that these wicked creatures are going about baiting the public utilities, they seem to forget that very large category of politicians who are employees of the utilities. We have a number of these in Maine. They became very active throughout the referendum campaign and went about speaking for pay. In fact, the campaign itself was conducted and managed by a member of the state Senate, who on the one hand was functioning as a state senator and on the other was functioning as the power companies' disbursing agent for this campaign. I think this is a very important aspect of the question which should not be lost to view when we consider the question of what goes in to make the rate base.

THE CHAIRMAN: Mr. Gruening's remarks have been interesting and pertinent. Possibly for some phases of the evils that he points out, the mere fact of direct publicity as illustrated by his speech is itself a form of remedy.

MR. MARTIN J. INSULL (President, The Middle West Utilities Company): I am very much in favor of what was just said with regard to publicity. The information that the last speaker received with regard to the transactions in connection with the sale of the Central and South West Utilities stock he got from the annual report of the New England Public Service Company. I would like to ask the last speaker what effect any of the transactions referred to had upon the rate base of the Central Maine Power Company.

MR. GRUENING: The campaign of education and propaganda and lobbying that was conducted over a period of four years previous to the brief, final effort came admittedly out of the state of Maine. That much was admitted by the executive in charge of the operating companies in Maine, at a legislative hearing held in Augusta, March 7, 1929. It is perfectly true that the \$197,000 or so taken from a Texas profit did not come out of the Maine consumer, but came out of somebody somewhere who had no relation to or definite concern

in the Maine problem. It came either out of the consumer in Texas by his failure to obtain a correspondingly lower rate or it came out of the investor in Texas with failure to get the amount of \$197,000 distributed in dividends. It came not for any purpose having to do with the distribution and sale of electricity in Texas. It went for the purpose of swinging an election in the state of Maine. I hope that answers the question.

THE CHAIRMAN: May I ask if Mr. Ferguson, the President of the Hartford Electric Light Company, is present? We would be glad to hear from him if he is here.

MR. SAMUEL FERGUSON (President, The Hartford Electric Light Company): I am impressed by one thought common to all of this morning's papers, namely, that the efforts of the past fifteen years to regulate utility rates have not produced results which are universally satisfactory. Reasonable regulation of these monopolies seems to have been accomplished in the matter of service and in the matter of safety, but there is a difference of opinion in the matter of rates.

The thought that came to my mind was: Do our difficulties arise from the fact that instead of trying through our tribunals to regulate rates, we are trying to regulate profits on the assumption that if profits are regulated, rates will be taken care of automatically? Is it a valid assumption that the regulation of profits is what is necessary to regulate rates? Of course, the commissions have had no yardstick for rates, and it is very natural to look on the regulation of profits as being the next best thing. I wonder if the solution of the problem will ever be reached until the commissions do what they are instructed to do, regulate rates, instead of trying to regulate profits.

If at some future time we devote as much effort to finding a yardstick by which to measure and regulate rates as we have devoted to the regulation of profits, perhaps more satisfactory results may be obtained.

The regulation of service and safety has been accomplished by creating yardsticks by which to judge them directly and with satisfactory results, and there seems to be no inherent reason why the same direct regulation might not be similarly developed as to rates.

MR. INSULL: I would just like to tell the gentleman from Portland where the \$197,000 (if that is the correct figure) came from. The securities in question had been owned by the New England Public Service Company for some two or three years. At that time the securities had a certain market value. It is perfectly

true that the New England Public Service Company bought them a little below the market price. When they sold these securities in the market at the then market price, they made the profit to which reference has been made. That is all I wish to say.

MR. GRUENING: Mr. Insull raises for me the interesting question, what would have happened if the market had happened to go down instead of up, and the further query as to how it comes about that a holding company, holding operating companies in three northeastern states, purchases securities elsewhere. Is it also a finance and investment company, and if so what relation would that fact bear to its stockholders if its investments were not good? Would that be an added charge to be collected from the consumer by the operating company? If not, how would these losses be taken care of? I am really seeking for information because I think that there is a whole realm of apparently unregulated activity which I think is worth discussing.

THE CHAIRMAN: This particular point in the history of the Maine campaign is interesting as a sidelight upon the current situation. The facts as to the precise details, of course, could not be very well threshed out in this body, as I am sure our friend understands.

DR. JAMES C. BONBRIGHT (Professor of Finance, Columbia University): I should like to express a desire on my own part and I think on the part of other students of public utilities, that Mr. Ferguson, the distinguished president of the Hartford Electric Light Company, be given the opportunity to explain to this audience how it is possible to regulate rates effectively by any other yardstick than by profits. Our own Commission on the Revision of the Public Service Commissions Law considered that question at some length, and so far as I can recall, there was only one witness who presented the point of view which Mr. Ferguson sponsors, and that was the late President Hadley. We studied President Hadley's testimony very carefully, and came to the conclusion, for reasons stated in the minority report, that regulation of rates other than by a test of profits was not feasible.

It may be that our conclusion was entirely unwarranted, and therefore I think it would be extremely valuable to hear Mr. Ferguson's own point of view. I am scheduled to speak this afternoon for twenty minutes, but I should be very glad to give up my time to Mr. Ferguson, reserving five minutes, perhaps, to comment on Mr. Ferguson's remarks.¹

¹ As Mr. Ferguson was unwilling to take Dr. Bonbright's time at the afternoon session, the program was continued without modification.—ED.

PART II
IMMEDIATE PROBLEMS IN
PUBLIC CONTROL

INTRODUCTORY WORDS¹

EDWIN R. A. SELIGMAN

Professor of Political Economy, Columbia University

THE few remarks which I desire to make on this occasion will be concerned mainly with the situation that will be, I trust, more clearly and eloquently described in the autumn, in connection with the formal celebration of the fiftieth anniversary of the foundation of the Academy of Political Science. As one of the very few survivors of those early years, I may be privileged in calling attention to the ideas which actuated us in that far-off time.

At the beginning, we had in mind an organization somewhat similar to the celebrated academies in the old world. There were, at that time, I think, only about one hundred members, very distinguished men, publicists, statesmen and scholars, who spent their interesting sessions in talking to each other about some of the newer problems with which this country, in its growing complexity, was being faced.

We soon found, however, that this more academic or esoteric movement did not quite suffice in a democratic community, and so we branched out and developed the Academy, such as you find it at present, with its appeal to a wider audience and with its thousands of members. We endeavored, however, to preserve the scientific detachment and all the amenities of scientific discussion which were more and more needed in our country as the practical problems became more acute and more controversial.

It is interesting to observe that in a great community like ours there are always some individuals who, in their business, or even in their professional life, will think almost exclusively of their own interests and their special opportunities. More and more, however, the distinguishing mark of American life

¹ Introductory address by Professor Seligman as presiding officer at the second session of the Semi-Annual Meeting of the Academy of Political Science, April 11, 1930.

—of American business life as well as of American professional life—is the recognition of the fact of social obligation. People may differ, and always will continue to differ, as to controversial questions, and as to what should or should not be done either by the individual or by government; but there is a welcome growth of the feeling that whatever may be one's own endeavors and one's own activities, they are really to be judged and estimated in the light of the social results.

Those among our business men and among our scientists who take even a very conservative view of what ought to be done, nevertheless maintain, I think with entire integrity, their attitude as one that is conducive on the whole to the public good. And the radicals among us likewise, of course, take a similar position.

The value of institutions like this Academy, is that they give the opportunity, in the welter and anarchy of conflicting opinions and of heated judgments on controversial questions, for a calm and a detached study which is calculated to instruct public opinion and which alone, in the long run, must be of significance in a democracy like ours.

This is especially true in the problem with which the present discussion is concerned. All of us, no matter what our opinions, are really interested in ascertaining—I do not say the truth because it is not a question of truth but a question of policy—the correct policy to be adopted; and the real criterion of that correct policy is the consideration of what, in final analysis, will best subserve the interests alike of the individual and of the community. Therefore I am confident that, this being our point of view and this being the object which we wish to attain, the present symposium will not be a conflict of personalities but a conflict of ideas and of ideals.

THE BREAKDOWN OF "PRESENT VALUE" AS A BASIS OF RATE CONTROL

JAMES C. BONBRIGHT

Professor of Finance, Columbia University

IT is seventeen years ago since the problem of rate control, which is the center of the discussion before the Academy today, was first discussed in any scientific way at an open forum. I refer to a conference of mayors held in Philadelphia under the auspices of Mayor Blankenburg to discuss public service regulation with special reference to the problem of valuation. As one looks back over the considerable period of years that has intervened between that meeting and this, and as one surveys the vast libraries of research studies, of public discussions and of case decisions that have been made on the subject, one cannot avoid a feeling of discouragement that the great issues which were raised at this early meeting remain so completely unsolved, and that instead of going on to the conquest of new fields, we find ourselves back in the old trenches that representatives of the public on the one hand and of the companies on the other hand had already dug themselves into in 1913. I refer particularly to the problem of valuation, to the question of discovering what is a fair value for rate-making purposes, or rather what is a fair rate base.

Even in that early day economists had pointed out with logic which no amount of sophistry has ever been able to answer, that *value of the property* as a basis of rate control is not merely impractical from an administrative point of view, but is based on an obvious economic fallacy. The fallacy lies in the fact that the value of a public utility property, no less than of any other business property, is simply a reflection of its expected earning power. To base rates on value is therefore to commit the fallacy of circular reasoning. For the value of the property is a resultant of the rates rather than a preëxisting fact by which the adequacy of the rates can be determined.

When the late President Hadley took the stand before the New York Commission on the Revision of the Public Service Commissions Law, he clearly pointed out the economic absurdity of value as a rate base and was unable to think of a single

living economist who did not accept this point of view. The fact that President Hadley refused to accept the most popular alternative basis of rate control, namely, the basis which has been called the prudent investment standard, is all the more eloquent testimony of the unanimous agreement of the authorities that, whatever basis of regulation is right, value as the basis is wrong. Yet even today the judge-made rule that public utility rates can be and should be determined by reference to property values is the accepted doctrine of the land, and even today the public utility companies through their legal representatives are doing their best to persuade the public that this legal Santa Claus really exists.

I cannot undertake here to explain why a doctrine based on so obvious an error of logic should have become the official doctrine of the Supreme Court of the United States, although I think the answer lies in the failure of the court at an earlier stage in its history to analyze the fundamental difference between the taking of property by process of eminent domain and the taking of property by process of rate control under the police power. Nor shall I attempt to point out how the court itself, recognizing to some degree at least the absurdity of following through its premise to its logical conclusions, has sought a partial though very ineffective solution by giving a peculiar interpretation to the concept of value, and by excluding from the valuation the one type of evidence which really bears on the value of any business property, namely, the ability of the property to earn profits.

One could forgive the verbal fallacy which courts commit when they call a figure, based in part on actual cost and in part on estimated cost of replacement, the "*value* of the property", if only the results which they obtain were satisfactory in practice. It is because these results are anything but satisfactory, it is because public service regulation has come close to a complete breakdown under the incubus of rate control by valuation, that the absurdity of the whole system stands in crying need of recognition, and that a fundamentally different program of rate control is called for if private ownership under commission regulation is to be made a success.

Having discussed elsewhere and at great length the specific program of the minority report of our commission by which

we hope to escape from the rule of present value as the basis of rate control, I shall not here defend this program or even attempt to explain its details. In brief, it accepts the principle that utility companies should charge such rates as will insure them a reasonable return on the actual legitimate costs of their property. Recognizing, however, that investors have already committed their capital under a different system of regulation, the plan of the minority would give to these investors not merely fair but generous treatment by allowing them to earn a return on a rate base measured by what the courts falsely call the present value of the property. Unearned increments to which utility investors are already entitled under the law of the land would thus be accorded them, but the door would be locked to the accretion of vast unearned increments in the future, and investors would be safeguarded to a far greater extent than today against unexpected decrements.

There are just two points of public policy which I wish to defend in this paper, but both of them are points the force of which will, I hope, be recognized even by those who disagree completely with the contention of the minority report that actual cost is the most desirable standard of regulation.

The first point is that, since public service regulation is of necessity a great experiment, not one but many different methods of control deserve both close consideration and careful trial. It has long been remarked by philosophers and social scientists that progress in the material and physical sciences has been extraordinarily rapid, whereas progress in the social sciences and in our economic and social organization has been notoriously slow. There are doubtless many reasons for this contrast between the advance in the material world and the lack of progress in the social world. But one of the most outstanding reasons lies in the comparative absence of the experimental method as applied to social organization. This difficulty will doubtless always persist because of the inherent obstacles against turning the world into an experimental laboratory. Only, however, by fighting against this obstacle, and only by trying worth-while experiments in a courageous spirit and with an objective criticism of results, can we hope for social progress and avoid social revolution.

Applying this philosophy to the problem of our public utili-

ties, we are brought to the conclusion, not that any one solution of the problem is *the* right one, and not that any one plan should be universally adopted, but rather that a wide degree of variation and experimentation should be encouraged. There are various forms which this variation may very well take. In some cases, where conditions are peculiarly ripe for it, direct government ownership and operation should be tried; in other cases a sort of community ownership in which the consumers themselves not merely own but control the utility may well be resorted to; in still other cases the policy suggested by President Hadley of private ownership with almost no control of profits may well be tried for what it is worth; finally—and just at this time, I think, most important of all—the prudent investment principle along the lines suggested in the minority report should be given a thoroughgoing chance to prove the merits which a long list of distinguished advocates, such as Mr. Justice Brandeis, the majority of the Interstate Commerce Commission and the Massachusetts Public Utilities Commission have claimed for it.

It is for reasons such as have just been suggested that I would express complete dissent from the point of view expressed by Judge William L. Ransom, the distinguished counsel of the Consolidated Gas Company, who spoke over the radio the other evening. Judge Ransom recognized that regulation at the present time is not all that it might well be, but he urged that there was no place in legislation for any untried theories in view of the great public and private interest involved. I pass by at this time the fact that the actual cost or prudent investment principle is not an untried theory and that it has had a long record of success in other countries and to a limited extent even in America. Just now I would prefer to raise the question how any theories can be tested out unless someone is willing to try them, and to try them on a scale of sufficient importance to make the test a valid one. When the Supreme Court in 1898 accepted the doctrine that "value of the property" should be the test of the constitutionality of a rate, that very court was doing what Judge Ransom urges us *not* to do today. It was experimenting with an untried theory, a theory which had never yet been tested in the history of the world. Events have shown, I think, that the theory then enunciated by the Supreme Court is not a workable one. Never-

theless, at the time when it was announced it was a plausible theory and, shorn of its obvious crudities, it probably marked the wisest course the court could then have followed. The time has now come, indeed it has more than come, when very different principles deserve a fair trial. The principle suggested by the minority has at least the merit that, even if it were very bad, it could hardly be worse than the one which is now the recognized law of the land.

This brings me to the second point of my discussion, which is really not a second point at all but only a corollary of the first. I refer to the claim made by public utility counsel and by the majority of our revision commission that the plan proposed by the minority is clearly unconstitutional because the Supreme Court in its wisdom has committed this country to a different plan. If the persons who took this position were confined only to those people who think that the minority plan is unsound and unreasonable to investors, their point of view on the question of constitutionality could easily be understood and sympathized with, even though their major premise as to the fairness of the plan might well be challenged. The amazing thing about this defeatist attitude toward the Constitution is that it is accepted by so many who frankly admit that the present value doctrine of rate control has broken down and who also admit that the alternative proposed by the minority is economically sound and is generous to the investors. It is a strange conception of the Constitution of the United States and a doubtful tribute to the intelligence of the Supreme Court to suppose, even in advance of any litigated case, that a plan which is fair is nevertheless unconstitutional, that a scheme which gives liberal returns to investors nevertheless takes their property without due process of law, and that the due process clause, so far from being a general rule of fair dealing between different classes of property owners, has degenerated, under legal decisions, into a body of formulae.

It has recently been argued by those who oppose any attempt to secure by legislation a fundamental change in the rules of rate-making which have been gradually built up by the courts through the process of case decisions, that this change itself would simply substitute a new body of legal formulae for the one that now prevails. It has been said, for example, that the plan suggested by the minority report of the revision com-

mission is an attempt to induce the Supreme Court to reverse itself and to accept a rigid rule that actual cost is henceforth to mark the constitutional minimum below which rates may not be fixed under the due process clause. If any such point of view has been suggested by those of us who sponsor the minority report, the fault lies in our failure to make our own position clear and not in the position which we ourselves would really wish to take. It would be just as critical a mistake for the Supreme Court to lay down the universal rule that actual cost or prudent investment or any other standard is the one basis to which all states must adhere in their control of utility rates, as it would be for the same Court to say that present value and only present value must be the universal rule. The Constitution of the United States was never intended as a substitute for legislative discretion in the exercise of those broad powers of the government which are known as the police power. The Fourteenth Amendment has always been interpreted by the Supreme Court as setting simply a limit based on decency and fairness beyond which a legislature may not go in the exercise of its wide range of discretion. Present value itself, as the phrase was interpreted by the Supreme Court, was originally a lower limit of decency, a constitutional deadline below which rates might not be fixed by act of a legislature or by order of a commission.

A series of economic circumstances has caused this standard no longer to constitute a lower limit. Indeed, the testimony of the public utility companies themselves is to the effect that it is now an upper limit, and that in their own self-interest the most prosperous companies, which have been earning for their stockholders profits beyond the dreams of avarice, have not cared to impose upon the public the rates which would be required under the prevailing law of the land. This means, of course, that regulation has become a farce. It means that the companies themselves, by reference solely to the dictates of their business interests, are to be the final arbiters as to what the public must pay for the service which they have been given the monopoly power to render.

It is for reasons such as these that our minority report concludes that abandonment of the present value doctrine is not the end, but the necessary beginning, of any effective system of utility control.

IS CONTROL OF OPERATING COMPANIES SUFFICIENT?

MARTIN J. INSULL

President, The Middle West Utilities Company

THE development of the country in the last twenty years is beyond our wildest dreams of two decades ago. Among the many industries that have helped in that development, that of electric light and power is outstanding. It has grown in breath-taking leaps—grown not for its own profit, but to meet an ever-increasing demand for its service by an ever-increasing host of satisfied customers.

Today this great industry has an investment of \$11,000,000,000 for the service of twenty-four million customers scattered from one end of the country to the other—located in city, town, and hamlet and on the farms. Its transmission and distribution lines cover the country in a closely woven network. Its service, once a luxury, is now a necessity in our business and social life. Its stocks and bonds are held by millions of our people. Fiduciary institutions are its creditors to the extent of hundreds of millions of dollars. On our stock exchanges its securities are the leaders. Many manufacturers would be compelled to shut down, some lines of transportation stopped, communication service crippled and our whole social structure seriously affected if its service should cease.

Its development in our country is greater than anywhere else in the world. Industrialists who visit us to find out why we lead the world industrially all leave our shores with the same answer in mind: "Cheap and abundant electric power everywhere and anywhere".

This has all been accomplished under private ownership and operation backed by the initiative and energy of an army of men and women in which personal ability, industry and loyalty bring advancement.

In less than fifty years this industry has grown from Edison's first central station on Pearl Street in New York to

its present proportions and importance. It has yet much to do. Indeed, it is now but launched on its greatest project of all—that of industrializing the farm and relieving the farm home of its drudgery. It is a record of which America as a whole is rightfully proud.

But there are those to whom success, particularly public success, is for one reason or another a challenge. What large amounts of time, money and effort are spent on investigating and reforming such successes! It is largely the success of this industry, so great in its service to the public, in its regular return in interest and dividends to the investor, in its help to manufacturing and in its part in the general industrial development of the country, that attracts investigation.

That there is no public demand for this investigation, is evidenced by the continuously growing business of the industry and the constantly increasing number of investors in its securities. Let us look the situation squarely in the face. Back of this agitation, discussion and investigation of the electric light and power industry is a comparatively small group—some social, more political, some sincere in their thought that it is for the public good, others sincere in that it may be to their personal interest, but all having in mind government ownership and operation of this great industry, either municipal, state or federal.

Critical discussions of rate of return, of valuation theories—even those laid down by the United States Supreme Court—and their effects on rates, of holding companies and of what they term the breakdown in state regulation of utilities, are all part of their attack on private ownership and operation.

It is becoming habitual to say that if regulation is a failure then the only thing left is public ownership and operation. Ownership and operation are not as simple as regulation. That was clearly demonstrated when as a war measure the government took over the operation of the railroads. During nineteen months of poor service to the traveling public, the government piled up a deficit of one billion, six hundred million dollars for the taxpayers to pay. The railroads were then returned to private ownership. It took millions to put them back into good operating condition.

Here in New York State, the records show that if freight

offered to the state-owned and operated canal were shipped by the state over the railroads at their highest rate, it would save money for the taxpayers.

Do not those who question the success of state regulation also inspire sober contemplation of the failure promised by the established history of public ownership and operation?

However, in the finality, the question will be settled by the American public, and I agree to the fullest extent with a recent statement that, "We do not feel that public opinion is yet ready for that alternative", and I hope it never will be. Regulation may not be perfect; but what is perfect? Certainly not government operation of any industry. That is a contradiction of democracy in government. Even Soviet governments have not yet proved that they can do it successfully.

State regulation of the electric light and power industry, notwithstanding any criticisms that may be made against it, has an enviable record to look back upon. It is this: a constantly growing, regulated industry of such financial stability as to attract from the investor the necessary new money at reasonable rates with which to enlarge and improve its facilities so as to provide service at continuously diminishing rates.

This does not indicate that state regulation has broken down, even if the regulating bodies, undermanned and with a limited force underpaid for the class of work expected of them, have not had time to initiate specific rate and service regulations where no demand for them has arisen.

The enviable record of regulation is not alone to the credit of the regulators but also to that of the regulated, who have as a whole faithfully coöperated with the regulating bodies to the end of mutual benefit to their customers and themselves. In 1912 the average price per kilowatt-hour for all electrical energy sold in the country was 2.62 cents. By 1917 this had been reduced to 2.09 cents. Then came the war, with increased costs of everything, and by 1922 the average price per kilowatt-hour had increased to 2.81 cents. That year the total sales were over 33½ billion kilowatt-hours. Last year—1929—the sales had increased to over 76 billion kilowatt-hours, and the average price had dropped to 2.57 cents. This drop in price below that of 1922 represented a saving to the public in 1929 of over \$182,000,000.

The average residence rate in 1914 was 8.3 cents per kilowatt-hour and the average consumption 268 kilowatt-hours. In 1929 the average residence use had increased to 488 kilowatt-hours and the average rate decreased to 6.19 cents per kilowatt-hour. Even if in some individual cases regulation could have been more efficient, these figures seem to me to indicate that it has been very successful in that both parties in interest, the operating companies and their customers, have benefited: the operating companies, by an increased business; their customers, by a decreased rate. And above all, the industry has been able to hold a high credit position enabling it to raise the money to build ahead of the ever-increasing demand for service made upon it by the public.

Consider the condition of the industry twenty years ago shortly after regulation was inaugurated in Wisconsin and then in New York. That was the day when the towns were served by little plants, poorly conceived and financed, running more or less intermittently from dusk to dawn for lighting only, for which the usual rate was about 20 cents per kilowatt-hour.

It was in 1910 that the tying together electrically of a number of towns in a given area was undertaken in what is now known historically as the Lake County, Illinois, experiment. Practically all the inefficient, small-town plants in the county were shut down and the towns were served by an interconnected system of transmission lines, fed from a then large and economical generating station capable of supplying electric energy twenty-four hours per day for all the homes, farms and industries in the county. Economically, the experiment demonstrated an increased capital investment with decreased operating expenses resulting in reduced rates, larger gross earnings and a fair return on the capital invested.

That experiment was the forerunner of the universal service of the industry today. The instigation of that experiment was private initiative and enterprise, which has always been the instigation of any real advances in the world.

In lecturing on this Lake County experiment before the Franklin Institute on March 13, 1913, Mr. Samuel Insull, who conceived and carried it out, visualized its possibilities as we see them in the industry today in the following words:

In the territory east of the center of the Mississippi valley it is not only possible but it is practically certain that we shall see in the next few years an opportunity to get cheap electrical energy alike in the country community and in the large city. . . . If it is possible to achieve anything like the cheap production of energy that a general unified system would bring about in the country districts as comparable with the prices paid for energy in large centers of population, what a difference it would make to our working population! . . . To my mind there is no more important factor in the great problems of life—the problem of how the working man can get fresh air, the problem of how he can bring up his family in healthy localities—than the proper solving of the economical generation and distribution of energy for country districts.

The natural development following the Lake County experiment has required in the last twenty years an investment of eight billion dollars by the electric light and power industry. The greatest financial task has been providing the equity or common-stock money, which had to be in the neighborhood of two million dollars, on a conservative basis of financing. This money has largely been supplied by the so-called "holding companies", for which a better name would be "utility investment companies". They were formed for this very purpose. Had it not been for them, it is very doubtful that this money could have been raised and that the remarkable industrial development of the country in this period would have taken place.

The utility investment companies raised the money they put into the common stock of the operating companies by selling their own securities, both senior and junior. They do not all use the same financial structures for this purpose, and some have raised part of it by maturing obligations, while others have done so entirely with different classes of stock—preferred and common. The assets back of their security issue are the common stock and other obligations of the operating companies and such miscellaneous assets as they have outside of the utility business.

The income of the investment or "holding" companies comes from earnings on securities owned—that which they may receive as bankers, or as experts for services rendered in utility and other fields. Charges of holding companies to their subsidiaries for expert services have been the subject of criticism where they are made on the basis of a percentage

of gross income and of total construction. If these charges have been above the market cost of such services the criticism is justified. However, whether these charges are made on a percentage basis or on a time basis for actual services rendered, they are subject to the revision of the regulating commissions in the course of their supervision of capital and operating expenditures.

In fact, the Wisconsin commission has recently sent to operating companies a questionnaire dealing with charges made against them by holding companies. As the active head of a utility investment company having subsidiary operating companies in twenty-nine states serving over four thousand communities, the average population of which is less than 1,800, I see no reason why there should not be a complete understanding between the operating companies and the regulating commissions in regard to holding company charges. Such charges should certainly not be greater than would be the market price for similar services rendered by outside expert firms which could render a service equal to that rendered by holding companies to their subsidiaries. It must be acknowledged that their experts, constantly dealing with utility problems, having utility experience covering wide fields, have a better knowledge of the subject than independent experts. This expert service to large operating units may be only advisory, because such operating units can support able utility organizations of their own. In these cases, however, it is my experience that it is many times sought and in most cases proves very valuable to the operating company.

I see no connection between the security issues of a holding company and the rates and service of its subsidiary operating companies. Holding companies, like other corporations, must have their securities passed on by state security commissions or approved by such authorities as they recognize before they are sold. As these commissions in many states, I believe, came into being after the utility regulating commissions, the regulation of operating company security issues has been left with the utility regulating commissions. Their real function, however, should be the regulation of rates and service and not that of regulating the issuance of securities. Their approval of the issuance of securities is in no sense a recognition of

those securities for rate-making purposes, since the rate base is that of value of property and has nothing to do with the securities issued.

I am raising no objection to present methods, as I recognize the necessity of their approval of security issues keeps the commissions informed on capital expenditures of the operating companies. On the other hand, I see no reason for regulating commissions to carry this extraneous function beyond where it is now to the regulation of securities of holding companies in which they have no interest except through the operating companies they were organized to regulate. The holding company or utilities investment company is entitled to the same freedom of action as any other business and it is that freedom that has enabled it to do the great work it has in the development of the electric industry in this country to a preëminent position in the whole world. Without it, that development would not have taken place and future progress would be materially retarded. In many ways the freedom of action of the holding companies has made electricity cheaper. This it has done by financing operating companies having wide transmission and distribution systems fed by up-to-date, economical generating units. By its constant efforts for lower costs of production of its operating units, it has enabled them to compete with all other prime movers for the industrial power business of the nation. Its operating units have introduced appliances and promotional rates which have increased the diversity and amount of the residence business. This has all been to the end that everyone may be supplied with electric service at continuously lowering rates.

The ambition of any far-sighted utility executive has always been and is today to furnish the best service at the lowest rate possible consistent with a good credit standing of the operating company. This is absolutely necessary in order for it to secure from the investing public the new money required to provide the consuming public with increased service. That is equally true of holding-company executives in relation to the operating companies in which their investments rest, as it is of the operating executives themselves. The ability of the holding company to help depends largely on its ability to act without restrictions other than those of ordinary private business.

To the credit of the holding companies is the passing of the small-town plant, bringing in its place the present operating units furnishing the same class of electric service to town, hamlet, and countryside as that given in metropolitan areas, and—considering the differences in density of population served—at comparable rates. This contribution in itself is having a very beneficial effect upon the economic structure of the nation, the possibility of which was pointed out seventeen years ago by Mr. Samuel Insull. Could this have happened under a restrictive policy towards the holding companies? In doing this, the holding companies have taken large risks in that their investment is in the junior securities of the operating companies, the senior securities of which are largely sold to the public. These have to be made good before those owned by the holding companies are good. In the early days of these operating units, this was not as easy as it sounds, or as it looks now, when one considers those units that have become seasoned.

The same element of risk which the holding companies can take, due to the geographical and industrial diversification of their investment in operating companies, is also present in the voluntary reduction of rates and the extension of service into new territories. Such reductions are made on the theory of increased business. If the increase does not materialize, the earnings of the common stock of the operating companies are affected, and many rates have been voluntarily reduced below the point of an existing reasonable return on the value of the property used and useful in the public service. It is equally true that if extensions into new territory prove unprofitable, again it is the holding company's investment in the operating company that suffers.

The risks in the power business are more than those arising from providing the equity or common stock money for the operating companies. That is only the start of a continuing risk. Furthermore, this equity money has to be continually increased in a growing operating company if its financial structure is to be kept in a condition to assure it of good credit.

The position of the holding company, therefore, is that of an enterpriser, and as such it is entitled to the same freedom as any other private business. The operating companies, on

the other hand, have a monopoly of service which, under most state regulating commissions, is protected by certificates of convenience and necessity which have to be obtained before they are subject to competition. Being so favored over the general private business enterprise, the operating companies should, as they generally have done, coöperate to the fullest extent in fair, just and lawful regulation of their rates and service. They owe this to their customers, and in the finality it is to their own benefit.

Regulation of the operating company with freedom of the holding company is to the best interest of the public. The public is thus protected against monopoly and has the advantage of the initiative and enterprise that financially strong private business brings to institutions where its money is invested.

Holding companies, therefore, should continue in the future with the same freedom of action that they have had in the past, under which they have done so much in this great land towards "Cheap and abundant electric power anywhere and everywhere".

THE "CONTRACT" METHOD

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IT is somewhat difficult to discuss this very technical subject with the necessary brevity. Even in attempting to run through the topic rapidly, I fear that I may have to appear somewhat dogmatic.

The critics of the present system of utility regulation center most of their criticism upon the "present value" system of rate regulation, that is, on the definition as laid down by the courts of a reasonable return on the present fair value of the property.

It is not within the proper scope of my subject either to defend or to criticize that system. I would be untrue to personal convictions, however, were I to neglect to say in passing that the statements about the breakdown of public utility regulation are considerably exaggerated, if we judge results, instead of approaching the subject on the purely theoretical basis of how difficult it may be to understand what the present system is.

If we consider, for example, that in the State of New York, which seems to be at present the center of investigation on this topic, the operating companies forming a part of the Niagara Hudson System, which sell more than half of the entire amount of electricity used in the state, do so at rates below those of any other system in the entire United States, it is difficult to say that regulation has broken down.

But, let us forget the false premise and go to the proposed remedy. There is no such thing as a definite contract theory. Every one of the politicians and the propagandists and the theorists who have attacked this problem has his own notion of the contract theory of regulation; but with all this wealth of individual ideas, it is possible to say that there are two major types of contracts, and these I would like to discuss.

The first type is a contract whereby the utility enters into an agreement with the state or with some agency fixing the

rates for household consumers of electricity for a definite period of time and within some restricted area. It is probable that such arrangements would be sustained by the courts if it were provided that the contract rates could not be changed without the mutual consent of both parties, and if, as the United States Supreme Court in some dictum has suggested, the contracts did not run for an unreasonable length of time.

Right there we reach an interesting problem. There is no law on the subject. One can only express a personal opinion. But it is entirely probable that the court, in trying to work equal justice between consumer and investor, as it has tried to do in the past, would determine what was a reasonable length of time for such a contract, depending upon the circumstances of each individual case. Where economic conditions were reasonably constant, probably the court would approve of a number of years. Where, however, economic conditions changed or great progress was made in the art of generating or transmitting or distributing electricity, so that the rates became unduly burdensome, or, on the other hand, too low to attract the capital which this industry needs, it is undoubtedly probable that any court would take those factors into consideration in determining whether or not the contract had run a reasonable length of time.

As a matter of fact, certain contracts of this sort might involve property rights, and therefore peculiar rules of law might be evolved which would apply to a particular contract.

Take, for example, this St. Lawrence problem which has been before us in one form or another, chiefly political in the past (and I hope that the political attitude will remain a thing of the past). It is entirely possible that in this instance a peculiar and different type of contract might be evolved. As you probably know, the state owns the bed of the St. Lawrence River. The courts have held that this ownership is a trust title for the benefit of navigation. Private interests own the banks of the river. It seems to be the settled law of this state that the owner of the bank of the river owns the right to use the falling water for power purposes. Now, it is entirely possible that in this situation a contract might be evolved whereby the private owners of the water power would allow some state agency to utilize their water rights in making the

development and would receive in return a contract to distribute the electricity and would agree that that electricity should be distributed at low rates to the householder and farmer and small power user.

With these property rights involved, it is entirely possible that this type of contract would be subject to no court interference, no matter what the duration might be. As a matter of fact, although the theorists on this subject fail to recognize the truth of this point and the all-important bearing that it has on the whole power-control problem, most of the business of the utilities is today conducted on a contract basis. Only about fifteen per cent of the electricity distributed by a system such as the Niagara-Hudson is sold to householders and to small consumers and for public lighting. The remaining eighty-five per cent is sold to large industrial users at rates which are competitively fixed by comparison with the cost of power generated by steam within the industrial plants, or in competition with the cost of power in other states and other countries of the world. These rates are largely fixed in long-term contracts. Such contracts fix prices of power, not rates of return, not ownership of property, but the price that people must pay. And those contracts have worked very satisfactorily.

By the same token, it is entirely possible that similar contracts negotiated as to household rates for limited areas might also work very satisfactorily, with one proviso. Such matters would have to be handled as matters of business alone and the withering hand of politics would have to be withdrawn.

There are inducements to a utility to enter into such a contract. It would escape, and its consumers likewise would escape, the very great expense of defending rate cases or of being regulated in connection with rates, and as a result it might well be able to enter into a contract free from this burden at lower rates than could be had under present conditions. Other inducements would be the better public relations that would result and perhaps the promotion of a greater sale of electricity.

However, let us not fool ourselves. This type of contract that I have just been discussing is not the type that the politicians or the theorists are interested in. Their dominant interest is not in the rates which the consumers are going to

pay, because today the consumers are satisfied with conditions as they are. The type of contract that they are interested in is something very different. It is a means of getting the utility to surrender by small degrees the management, the ownership, of its property to some public agency or to the state itself. It is a step toward public ownership.

It is very plain, after listening to Professor Bonbright,¹ that contracts of this sort which these people have been advocating are devised in an attempt to get the utilities to contract away the Fourteenth Amendment of the United States Constitution.

The methods suggested to get the utilities to enter into such contracts are very different from those inducements which exist in connection with the first class of contracts and are more in the nature of coercion. Certain methods suggested are to limit the life of a corporation and let it go out of existence, or to forbid it to issue securities to maintain, extend and improve the service to its consumers, unless it will enter into such a contract as the state desires.

Under this second class of contracts, it is usually provided by those plans that have been worked out with at least some little regard for constitutional law, that the utility should be allowed to set up the fair value of its present property and then should receive a reasonable return on that value; but that all property added afterward should be valued on some prudent investment basis or some other such theory, and as to that the rate of return would be limited to the interest on the bonds, the fixed dividend on the preferred stock, and a fixed dividend rate on the common stock as determined by the contract or by the state. All existing property re-financed through the refunding of security issues or otherwise is to be added to the new property class.

This plan is not quite as simple as it sounds. With the vast growth of this industry, with the rapid improvements in the electric art, even under the shortest contracts, the bulk of the property would very soon be changed from the initial valuation class, on which a reasonable return was to be allowed, to the property addition class, where this limited rate of return was fixed.

¹ Cf. *supra*, pp. 75-80.

Under such circumstances, it is obvious that any utility which was coerced into such a contract would be bound to insist on receiving the maximum legal return on the initial valuation in order to offset the deficiency of return on the balance of the property and so protect itself against lean periods and enable itself to carry on its service in the future.

If that were done, except in those rare cases where utilities are charging rates up to the maximum legal limit—and I believe they are the rare cases—the application of such a plan as these theorists have been talking about would result in an immediate increase in rates to the householder. There is no other answer to it. The companies would be forced by the very terms of the contract to make such an increase.

While the academic minds may like the theory of such a class of contract, it would produce the most startling results. Take an average community where there is one large industry and many householders: domestic rates would be provided under this contract theory sufficient to pay the interest on the bonds, fixed dividends on the preferred and common stock, depreciation reserves and operating expenses, and then the balance would be paid into, I think they call it, a "rate equalization reserve." That rate equalization reserve would have certain maximum and minimum limits. When it got too high, the rates to the householder would be lowered; when it got too low, the rates to the householder would go up.

Suppose in this average community, typical of many in this state, for some reason the large industry is shut down and large numbers of people are thrown out of work. These people, perhaps the very householders in this community who are out of jobs, would immediately be forced to pay rates for electricity in their homes two and perhaps three times the previous rates, because the revenue from the industry which was carrying a large burden of the cost of electricity in the community would be gone and the rate equalization reserve would be wiped out in consequence. Under the present system the utilities would not consider raising rates in such a period of depression, but under this kind of contract no other course would be possible.

I am inclined to believe that the consumers would prefer the theoretical uncertainties of the present system, with low and constantly decreasing rates, to the certainties of a fixed rate

base and fixed rate of return with high and fluctuating household rates that would result from this type of contract theory.

It is very doubtful if the management of utilities would feel they had the right to enter into such contracts without at least the full consent of their stockholders, because they might well be personally charged with a dissipation of the assets of the corporation. It is hard to believe the courts would sustain any attempt to coerce the utilities into this type of contract.

Wholly apart from these objections—and there are many more that could be pointed out—my most fundamental objection to this type of contract is that it is a method of transferring, by slow degrees, the ownership and value of the property from the stockholders and the investors to the state, without transferring the responsibilities that go with that ownership of property. That is what is fundamentally unsound about it. As these minority members very plainly stated before the legislature last week, they are really trying to take a step towards public ownership. Mr. Walsh, one of Professor Bonbright's associates, said he did not believe the time was quite ripe, whereas Mr. Norman Thomas stated that he thought the time was entirely ripe for full municipal ownership or public ownership.

If I might use a homely example, to contrast these two types of contract theories, I might be willing under the first type of contract, if I owned a farm, to make a lease of it at a very low rental for various considerations. Under the second type of contract, I would be required to put in my contract that my farm was not worth anywhere near as much as I sincerely believed it to be worth, and that its value and control were to be constantly taken from me. That is the difference, in homely language, between these two theories.

As a matter of fact, I would prefer the honest hemlock cup of public ownership, honestly arrived at, which would mean the direct appropriation of these properties and payment of their values to their owners, than the slow poisoning by this second class of contract which would mean the whittling away of the value of the investor's property and interference with good management. It seems to me that while the first class of contract has certain possible advantages to both the stockholders and the ratepayers, the second class is fraught with the most serious economic and constitutional dangers.

THE COURTS AND THE ATTRACTION OF CAPITAL

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I am a politician and a theorist; for according to the preceding speaker's definition those terms are apparently applicable to anyone who is not paid for advocating the views he puts forth, when those views differ from the paid advocate's.¹ But to proceed with the discussion:

A rate may be far more than adequate for the attraction of capital without coming anywhere near the high extreme which the courts will pronounce "non-confiscatory." In fact that is the precise situation in which the Consolidated Gas Company contends that it finds itself: it asserts that it earns far less than a fair return on its fair value, yet it has no difficulty in marketing its securities. Reproduction cost has nothing to do with the attraction of capital. The capital that has to be attracted is the amount which the investors must contribute for the actual cost of the property—they do not have to contribute the amount which it *would* cost to reproduce it at some period later than at which it is produced. What induces the investor to invest is the total annual return which he thinks he is likely to receive in relation to the amount which he decides to invest. But in the cases that have been presented to the courts, the attraction of capital has not been the only factor they were free to consider. The courts have been faced with the necessity of determining how much protection should be accorded to property values already accrued under a system which has permitted anticipation of more than the minimum needed to attract capital. Had the Supreme Court adopted actual cost as the rate base, it would have sanctioned a rule which might have permitted states to reduce values, for which present security owners had paid in good faith, to a level not contemplated at the time when they bought their securities. To avoid destruction of value, the court enunciated the rule re-

¹ Cf. *supra*, pp. 90, 92.

quiring a fair return on value, not realizing that every reduction of anticipated net earnings must necessarily effect *some* reduction of value. In most private enterprises competition is likely to keep the earning capacity in some sort of relation to the replacement cost of the plant, and, hence, the latter would be a relevant factor in the ascertainment of value. The court has assumed the same thing to be true in regard to public utilities. It is this supposed relevance of reproduction cost to value, not to the attraction of capital, that accounts for the insistence of the courts on giving it consideration.

The minority of the Knight Commission have recommended the enactment of a statute which will, except at the outset, render reproduction cost irrelevant to all purposes. This recommendation is known as the Bauer Plan. It would require an initial valuation and an initial rate of return to be fixed for all existing properties. Thereafter the rate base could be increased only to correspond to additional contributions of capital made by investors. The plan has been pronounced unconstitutional by Colonel Donovan and Senator Knight, who recommended instead a policy of sweet reasonableness with no compulsion exerted against the utilities. Meanwhile Judge Ransom has demonstrated how effective this gentle appeal to the utilities is likely to be; they will not voluntarily forego their pound of flesh even for the proposed period of ten years. Before resorting to the anarchistic utopia of non-compulsion, it might be worth while to inquire more closely into the constitutionality of the Bauer Plan.

There is no express language in the Constitution which it violates. But what Colonel Donovan has in mind is doubtless the holding of the Supreme Court requiring a fair return on the value. The Bauer Plan, when closely examined, does not violate this rule. At the time of its enactment, it would not reduce the already existing value in any greater degree than is permissible under the present system, for the initial valuation is the same. If the removal of the opportunity for future gain has any tendency to depress existing values, this tendency will be offset in part by the state's policy not to force rates downward to a fair return on less than the initial valuation, merely because reproduction cost should fall. Should this offset be insufficient to maintain present value, that end could

be attained by setting sufficiently high the "frozen" rate of return on the initial "frozen" investment.

Later on, however, if reproduction costs should rise, the effect of the continued enforcement of the Bauer Plan would be to prevent the company from obtaining a return on an amount in which current reproduction cost would play any part. But this would not be to give the company less than a fair return on its current value, for the previous enactment of the plan would have broken the chain which links current reproduction cost to value. The reason why the property would never have attained an increment commensurate with the increased cost of reproduction is that the market would have anticipated no advantage therefrom. The Supreme Court has more than once¹ been at pains to point out that reproduction cost is to be given only such weight as under the circumstances is appropriate to the ascertainment of value—which would here be *nil*. The statute proposed would change the state of the title, and as the court insisted in *Boston Chamber of Commerce v. Boston*, 217 U. S. 189 (1910) —a condemnation case—"the constitution does not require a disregard of the mode of ownership,—of the state of the title."

The Bauer Plan, then, neither at the time of its original enactment nor at a subsequent period of increased reproduction cost, can be said to violate those decisions which require the rates to yield a fair return on the preëxisting value. It would, however, deprive the investors, at the time of its enactment, of the speculative possibility of reaping as great a future increment as the present system might enable them to reap. But this possibility is a valuable property right only in so far as it is now reflected in the present value, and of that there is no proposal to deprive them. If their property were to be appropriated now by condemnation, they would be fully compensated by the payment of the present value of this unrealized potential increment, though it may turn out later to be much less than would have been the realized increment had the appropriation not been made. The Bauer Plan is similar in its effect. The investors at the time when the law alters the state

¹ Cf., for instance, the language of Justice Butler in *Brooks-Scanlon Corp. v. U. S.*, 265 U. S. 106, 125; 44 S. Ct. 471 (1924).

of their title will have property with a market value equal to that of the unrealized opportunities; and this is full compensation, though it later appears that the realized increments, had the state of their title remained unchanged, would have exceeded the earlier value of the mere possibilities. The only difference to the investors between the Bauer Plan and condemnation is that instead of cash they will have under the Bauer Plan securities which for all practical purposes are equivalent to cash. These securities, unlike real estate, are liquid and can be converted at once into cash. To say that the Supreme Court will for this reason hold the Bauer Plan an unconstitutional deprivation of the existing property rights, while a condemnation which has the same practical effects on the investors would be valid, is to say that the court will determine the question of constitutionality on a ground of form rather than of substance.

As far, then, as the property rights of existing investors go, they receive full compensation at the time of the enactment, and the continuance of the scheme in operation will thereafter deprive them of nothing to which they have not already lost their rights at the time of the enactment. Their only remaining complaint can be that, in common with non-owners, they will no longer have the liberty to speculate for increments in utility stocks as great as those for which they may now speculate. But this liberty could without any question be constitutionally destroyed if the state were to condemn all public utility properties, and to embark on a scheme of state monopoly of ownership and operation of utilities. However bad such a scheme would be, it would be perfectly constitutional. The Bauer Plan is less radical. It would limit the opportunity to speculate, not in behalf of a policy of government ownership and operation, but only in behalf of a system of regulation which makes an initial compromise out of fairness to vested rights, and which then proceeds, as is not otherwise possible, with an eye single to the need for attracting capital.

Is this limitation of the field for speculation unconstitutional? The Constitution itself nowhere expressly says so; nor do any decisions of the Supreme Court. If unconstitutional, it must be because that court will view its object as so arbitrary as to amount to a deprivation of liberty without due

process of law. But if that particular liberty can be taken away on behalf of public ownership, without violating the Constitution, why assume that the Supreme Court will regard a workable scheme of regulation as a more arbitrary object? Are the judges such partisans of public ownership? Or is it that Colonel Donovan and Senator Knight hold such a low opinion of the capacity of the judges for clear thinking?

[100]

THE MASSACHUSETTS PROPOSALS FOR PUBLIC CONTROL

LEWIS GOLDBERG

Commissioner of Public Utilities, Massachusetts

MASSACHUSETTS believes that public utilities should be so regulated as to serve at all times the best interests of their owners and of the public, that the principles guiding regulation should be economic rather than purely legalistic, and that no rigid rule of regulation can or should be applied to all utilities at all times, without variation.

Underlying the whole problem of regulation is the method of determining the value of the utility for rate-making purposes. The rate base—the amount on which an opportunity should be afforded to earn a fair return—should be certain and readily ascertainable. It should not fluctuate with every economic tide or be driven by every economic wind. The investor puts so many dollars into the enterprise; he should get a fair return on that money.

The public grants the utility the sovereign right of eminent domain which can be justified only on the theory that the utility is acting on behalf of the sovereign for the public benefit—as a public agency. It authorizes the utility permanently to occupy portions of the public highways. It gives the utility a monopoly. It is entitled to as low rates as can be made, consistent with fair treatment of the utility. It would be entitled to reasonable rates merely as a *quid pro quo*, even if the business were not public in its nature.

To be effective, regulation should be speedy. It should not involve expensive litigation. It should not compel frequent recourse to the courts, which have no power to fix rates but can only affirm the commission's order or enjoin its enforcement.

We believe that these results can be most fairly and effectively accomplished by basing valuation on the amount of money honestly invested by the stockholders in the utility

and by having an elastic or variable rate of return. Under this view the rate base is at all times certain, stable and easily determined. By an elastic rate of return we can adjust the rate to the needs of the specific utility and to all the changing and varying economic circumstances. The commodity rate should be sufficient to pay operating expenses, set aside proper depreciation, pay fair dividends, maintain the credit of the company enabling it to borrow money for its needs at reasonable rates, attract new capital, and keep the stock of the utility somewhat above par. If we do this, we are dealing fairly with the utility owner, since we are allowing him a fair return on his investment, permitting him to maintain the integrity of the property and enabling him at all times to sell his stock and get back all the money which he invested.

This is the policy of regulation which we follow in Massachusetts. We regard the money honestly invested in the property by the stockholders as the valuation of the utility for rate-making purposes. This is not a new conception in Massachusetts; it goes back more than 125 years.

Beginning with the regulation of rates to be charged by turnpikes in 1804, when the statute specifically made the investment by the stockholders the rate base, successive statutes, dealing with railroads and street railways, down to practically the beginning of the present century, established the investment as the amount upon which the utility was entitled to earn a fair return. From the time when our first Railroad Commission was established in 1869 and our first Gas and Electric Commission in 1885, this policy of treating the honest investment as the rate base has been consistently followed.

Under this method of regulation our electric utilities have prospered. They have paid excellent dividends, set aside ample depreciation and built up large surpluses. In forty-five years of regulation of electrical utilities, only two cases—the Worcester and Cambridge cases three years ago—went to the courts, and those were dropped by the respective companies. In the last sixty years not more than four rate cases affecting all kinds of utilities and not more than ten or twelve cases affecting all matters were brought in the courts. Can there be any better evidence of the satisfaction afforded by the Massachusetts system of regulation?

The rising tide of the reproduction theory, which received such a tremendous impetus because of the increasing prices of labor and materials during the war and for a number of years thereafter, also washed our shores, but, like all tides, it receded. Some of our electric utilities saw visions of greatly increased rates, or, at least, of preventing proper reductions in rates, under a valuation based on reproduction cost of physical property less depreciation, embellished by the intangible elements of value. These intangible factors seem to know no limit except that placed by nature upon the ingenuity of experts to conceive of new elements of value. They appeared in full force in the few cases where the reproduction theory was seriously urged by utilities on our Massachusetts commission. Experts solemnly testified that a pond which, together with some land, was purchased for \$69,000 several years prior to the hearings, should be valued for rate-making purposes at the modest sum of \$1,200,000. An office building, fifty years old, located in the heart of the city, was depreciated for rate-making purposes only five per cent of the reproduction cost for the entire fifty years. Can you guess what the depreciation was on that building for tax purposes? Or, how much depreciation reserve had been set aside for it and paid by the consumers? We learned that cast-iron pipes should not be depreciated at all, because such pipes laid in the days of the Caesars had been dug up in the Appian Way in recent years and found still to be in good condition.

We were seriously told by learned counsel that the United States Supreme Court had made reproduction cost less observed depreciation, if any, synonymous with present value and that any commission that departed from that view was guilty of little short of treason. As we read the cases from *Smyth v. Ames* to *The O'Fallon* case, that court has never repudiated the doctrine of *Smyth v. Ames*, and has never made reproduction cost less depreciation *the* measure of present value. On the contrary, from 1898 to the present day, it has repeatedly reaffirmed *Smyth v. Ames* and has merely held that reproduction cost less depreciation is *one* of the factors, among many others, to be considered in determining present value and may be, under certain conditions, *a* measure of value—not *the* measure.

Our experience in Massachusetts with the attempt to make reproduction cost less depreciation the rate base has been that it fosters litigation, prolongs rate cases *ad nauseam*, piles up expenses for experts and counsel which the consumer ultimately must pay, engenders ill-will towards the utility, and tends to make regulation ineffective.

In my opinion a threatened breakdown of effective regulation would never be tolerated by the people of Massachusetts. It would drive us to public ownership. We now have forty-three municipally owned electric plants in Massachusetts which are operating effectively and efficiently and furnishing electricity at rates lower than those of private companies in their immediate vicinity. The enforcement of the reproduction theory as a rate base would in Massachusetts probably lead to the establishment by the state of huge generating plants with transmission lines radiating throughout the state, carrying power which would be distributed and sold by the municipalities. We could do it, charge the people reasonable rates and give them good service. I do not advocate this. I do not advocate municipal ownership. I would rather see this service performed by private companies, properly regulated by public authority. But the spirit which prompted the Boston Tea Party is still strong in our people, and a serious attempt on the part of the electrical utilities to extort unreasonable rates based on fanciful or fictitious valuations would drive us to public ownership just as surely as the sail is driven by the wind.

We are not attempting to foist our views upon other states. We are not even urging them to follow our example. We do say that the adoption of honest investment as the rate base and of an elastic rate of return makes for more effective, efficient and speedy regulation, is eminently fair to the utility and to the public, and is economically sound. We have demonstrated this fact in actual practice, covering a longer period of time than the comparable experience of any other state in the Union. If generally adopted, it will practically put an end to protracted rate litigation, relieve the courts from rate cases, make for much better public relations, and redound to the benefit of the utility as well as the public.

The problem of regulation of electrical utilities has become

more complicated by the rapid development of holding companies. We, in Massachusetts, are not excited about them. They have their advantages, and they bring potential evils in their train. The mere ownership of the local utility by a holding company is of no more consequence than the diffusion of ownership among a large number of individuals, but the use that is made of that ownership may be of grave consequence. The essential thing is the regulation of the local utility. If we can effectively do that, we care not who owns it.

To prevent abuses by the holding companies, we believe that the public regulatory body should have the power in any rate case to pass upon the reasonableness of the price paid for power by local utilities and also to pass upon the fairness of the price paid to the holding company or its subsidiaries for services. Upon the recommendation of our commission, the legislature, four years ago, enacted a statute which provides that no contract by an electric company for the purchase of electricity for a period of more than three years shall be valid unless it is first approved by the commission, or unless it contains a provision to the effect that the price shall be subject to review and determination by the commission in a rate proceeding.¹ With such a statute in effect the commission cannot be defeated in an effort to establish reasonable rates by the contention that the electric company is bound by contract for a long term of years to pay an unduly high price for electricity. If the utility enters into a contract for less than three years and the price paid by it is unreasonable, the period during which the utility is bound is so short that the commission in its determination of rates may easily take care of the situation.

Similar legislation relative to contracts for services made by electric utilities should be enacted. There is now pending before our legislature a bill which provides that no contract made by a gas or electric company, covering a period in excess of one year, under which any compensation is to be paid by the company in whole or in part for services, shall be valid unless it is approved by the commission or unless it provides that the amount of compensation shall be subject to review and determination by the commission in a rate proceeding.

¹ Mass. Statutes 1926, C. 298.

It may well be that even without such legislation commissions may, under the doctrine of *United Gas Co. v. Railroad Commission*,¹ disregard contracts for the sale of electricity or for services made between the local utility and the holding company or any of its subsidiaries whenever the price to be paid is higher than that which would have been agreed upon if the parties were dealing at arm's length.

The commission should also be given the power in a rate proceeding to obtain information from the holding company and to examine its books. If legislation such as I have suggested should be enacted and if the commission functions properly, I see no occasion at the present time for further regulation of holding companies aside from "Blue Sky" statutes. If time and experience should demonstrate that further regulation is necessary, additional legislation may then be secured.

Lest the various state commissions should feel that their problems are not sufficiently difficult, it is now proposed in some quarters that the federal government should enter the field of regulation of electrical utilities. We, in Massachusetts, are opposed to that. We feel for one thing that the federal government, instead of merely entering the field, will preëempt the field. Solely from the viewpoint of regulation and without regard to the question of state rights, this would deal a body blow to effective regulation. We all know how little power the state commissions now have over intra-state railroad rates. Federal regulation of electrical utilities, however limited in scope at its inception, would without question so increase that state regulation of rates would, as a practical matter, be broken down. Local electrical utilities are not analogous to railroads. Their rates are not involved, as those of railroads are, in transcontinental or even interstate problems. They are, in the main, subject to local factors. The chief elements of cost lie in the local distribution lines. Density of customers per mile of line, overhead or underground construction, load factors, habits of people affecting the use, and various other elements which enter into the problem, are purely local factors. They should be determined locally.

Regulation should be speedy. If the public is entitled to

¹ 278 U. S. 300.

lower rates, it should receive them without undue delay. If the utility needs higher rates, relief should be afforded to it as quickly as may be. This, in our opinion, is impossible under federal regulation, and I say this without disparagement, even by innuendo, of the Interstate Commerce Commission. It simply is impossible, effectively and efficiently, to regulate a local utility at long range by means of a commission working out of Washington for the entire country. Such a process is necessarily slow and cumbersome. It cannot, in the nature of things, give adequate consideration to the problems. It savors of absentee landlordism.

Nor does there seem to be any necessity for federal regulation. The total amount of interstate electricity is comparatively small. Even if this should escape regulation at the hands of state commissions, there is no sound reason for breaking down state regulation and substituting therefor ineffective federal regulation in order to remedy a very minor possible evil. Federal regulation should be thought of only as a last resort.

In conclusion, the thought should again be emphasized that regulation of public utilities should not be carried out according to abstract legal rules interpreted by cold legal reasoning. Rather, it should be recognized that the problems are purely economic and that economic laws, construed in the light of practical business experience, common sense and reality, should be controlling.

THE REGULATION OF HOLDING COMPANIES

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THE intense interest in holding companies owning or controlling the stock of public utilities is causing careful study of present-day operating and financial practices of such companies. A determined effort is being made to bring them within the regulatory powers of state or interstate commissions. Exhaustive investigations have been made, and others are contemplated, to ascertain the extent and effect of their transactions and to propose suitable legislation.

This new development causes inquiry with respect to the extent of control of operating utilities, the legal questions involved in efforts to bring about effective regulation of holding companies, and the means of reaching them if not within the jurisdiction of the commission seeking such authority.

Operating utilities selling service to the public are, of course, subject to regulation. Commissions having jurisdiction may protect the rights and interest of the public under authority to:

- (a) Determine the reasonableness of rates, and prescribe them, based on the value of the service and the rate of return.
- (b) Determine the rate base under valuation provisions.
- (c) Hold that the return on such rate base is reasonable or unreasonable according to the circumstances shown.
- (d) Prescribe classifications of accounts, require reports, and have access to records.
- (e) Inquire into contracts and expenses to the extent necessary to determine whether rates charged the public are reasonable.
- (f) Demand that unreasonable expenses charged in the accounts shall be excluded in computing net return.
- (g) Prescribe classes of depreciable property and rates of depreciation charged in expenses.

- (h) Determine the sufficiency and efficiency of service rendered.
- (i) Authorize extensions and additions or construction of new lines by certificates of convenience and necessity.
- (j) Authorize security issues.

These powers are now possessed by regulatory bodies under the usual provisions of law, both state and interstate. They appear to embrace ample control of operating utilities furnishing a public service. Is it necessary to go back of the operating companies and to obtain supervision over the owners of the property, the stockholders? Holding companies, in a broad sense, are the stockholders. There are, however, several classes:

1. Where there is a quasi-operating relationship, the holding company having some measure of supervision, making purchases or rendering engineering and other technical services, or providing for purchases or services for the operating company from other units of the holding company's organization. This class is usually characterized by contracts between the holding company and the operating subsidiaries covering such management matters. In some instances there is a separate affiliated management company.

2. Where there are sales of the entire output of the holding or producing company to the operating subsidiary, or where there are sales or leases of apparatus or facilities to the operating company. Frequently there are elements of both the first and second class in one instance, and sometimes there is disregard of the subsidiary corporate entities.

3. Where there is merely ownership or control of securities of operating utilities, the characteristics of an investment company prevailing.

Probably even those who advocate holding company regulation would agree that companies of the description of those in the third class hardly need to be subject to commission supervision, particularly if information is disclosed by operating utilities concerning stock ownership. However, in the widespread demand for regulation of all holding companies, largely because of the multiplicity of security issues and in-

volved intercorporate relationships, distinction between the classes named is not always observable.

The practical advantages and disadvantages of the holding company system, particularly those within the first and second classes, have been presented in some of the investigations and discussions of the subject. Advantages claimed are: that the public is benefited by large-scale financing affording financial arrangements which could not be obtained by small companies; mass purchases with reduced costs; consolidated management resulting in lower costs and also more efficient technical and managerial talent; intensive research work resulting in advancement of the industry and benefit to the public served; economies from large-scale production; more efficient service to the consumer growing out of greater diversification in product and service rendered; and in many cases, reduced rates charged the public.

Among the disadvantages which have been pointed out is, that the purchase of operating utilities, frequently at inflated prices because of competition between holding companies seeking to widen their field, is considered to contain elements of danger to the public interest. It is believed by some that the volume of stock issued by the holding companies may conceal excessive total profits notwithstanding the circumstance that the dividend rate may be moderate; that the increased number of shares in the hands of the public exerts pressure on the regulating body to allow rates commensurate with such capitalization; that where predominant consideration is given to investment, the rates charged the public will be high; that while this effect need not result where cost of reproduction of the plant devoted to the public service is given effective consideration, yet the reproduction method requires intricate valuations necessitating long and expensive hearings in case of rate complaints. Partly because of valuation difficulties, a new element in fixing the rate base has recently been suggested by the Massachusetts and New York investigating commissions, that of fixing the rate base by contract between the utility and the commission. The validity of such a plan will of course be tested. It has also been claimed that under the management system the centralized or closely coördinated control of operating utilities has disadvantages offsetting the advantages

claimed for it, that in transactions between the companies the usual elements of bargain and sale are lacking; that prices paid by the operating utilities for purchases or services are reflected in increased revenue to the holding company, and if excessive the consumer suffers. While in some instances such contracts result in substantial economies, it is claimed that in other cases they cause needless increases in expenses.

In view of these divergent views the Massachusetts Special Commission on Control and Conduct of Public Utilities in its report in March, 1930, recommends certain statutory changes to obtain information from holding companies but no direct regulation of them at the present time. The New York Commission on Revision of the Public Service Commissions Law, in its report submitted the same month, recommends that the jurisdiction of the commission be extended to the holders of voting capital of utilities to require the disclosure of interests, and jurisdiction over affiliated interests having transactions with utilities to the extent of access to accounts and records and the filing of reports, also advance approval of contracts with utilities.

Other investigations on the subject are pending. The Federal Trade Commission, under authority of Senate Resolution 83, approved February 15, 1928, has been conducting a most exhaustive investigation relative to the organization, control and ownership of electric power, light and gas utilities, and the effect of intercorporate relationships. A congressional investigation of the railroad holding company situation urged by the Interstate Commerce Commission has been authorized by House Resolution 114, adopted January 24, 1930, and hearings are just commencing in April.

An analysis of the situation with respect to holding companies of the first and second classes above referred to shows that their services and facilities are furnished not to the public but to the operating utilities. They are not furnished to other utilities outside of the holding company's organization, and particularly not to the public. The public has no right to demand a continuance of the services furnished and can only be interested indirectly if charges to the operating companies are proved to be exorbitant or if unconscionable contracts have been entered into. In such instances the commission may in-

quire into the matter and, as commissions have done, demand that excessive expenses or payments under contracts be disregarded in ascertaining the rate of return on the value of property used, and the net income modified for that purpose. It seems that services, materials or facilities furnished to operating utilities and not to the public should not bring such holding companies within regulatory principles where there is a well defined line of corporate management, and the corporate entity of the subsidiary is respected by the holding company.

The established rule must be kept in the foreground that property is subject to public regulation only when affected with a public interest. The outstanding decision of the Supreme Court of the United States on this subject, which has been followed since 1876, is *Munn v. Illinois*, 94 U. S. 113. The holding of the court in that case, which has been quoted many times in other decisions, was in substance that property becomes clothed with a public interest when used in a manner to make it of public consequence and to affect the community at large; that when one devotes his property to a use in which the public has an interest, he, in effect, grants the public an interest in that use, and must submit to be controlled by the public for the common good. Subsequent decisions in discussing the question have held that there must be a dedication of property to the public service before there can be regulation, and the dedication to public use must be of such character that the public has the right to demand that the service shall be conducted with reasonable efficiency and under reasonable charges.

Rather than falling within that rule permitting regulation, the reasonable view regarding the first two classes of holding companies is that they come within the principle stated by the Supreme Court in its decision in *Chas. Wolff Packing Company v. Court of Industrial Relations of Kansas*, 262 U. S. 522, decided in 1923, where supervision was sought over companies furnishing food products. The packing company had been served with an order by the Industrial Court respecting wages paid to its employees, and the constitutionality of the act was in question. The court held that the business sought to be regulated was not of a nature bringing it within established principles of public regulation, and that "the mere declaration

by a legislature that a business is affected with a public interest is not conclusive of the question whether its attempted regulation on that ground is justified." This principle has been followed in more recent decisions relating to the subject of price fixing, and in every case it has been held that a state legislature is without constitutional power to fix prices at which commodities may be sold, services rendered or property used, unless the business or property is affected with a public interest.¹

The difference between the power to fix prices and the authority to regulate the conduct of business was pointed out in *Tyson & Brother v. Banton*, 273 U. S. 418. There may be police regulations, requirements for licenses, etc., to regulate the manner in which the business may be carried on, but the basis applicable in such instances does not embrace the broader condition with respect to property affected with a public interest. The court in the *Tyson* case said: "The power to regulate property, services or business can be invoked only under special circumstances; and it does not follow that because the power may exist to regulate in some particulars it exists to regulate in others or in all." And concerning evils claimed to exist: "It is not permissible to enact a law which, in effect, spreads an all-inclusive net for the feet of everybody upon the chance that, while the innocent will surely be entangled in its meshes, some wrong-doers also may be caught."

The disclosure by utilities of information pertaining to outside business or interests, sufficient to ascertain if there is concealment of forbidden practices, is within the jurisdiction of the commission under the usual type of statute. The power of the Interstate Commerce Commission in this regard was upheld by the Supreme Court in 1912 in *Interstate Commerce Commission v. Goodrich Transit Co.*, 224 U. S. 194, where the court said:

If the Commission is to successfully perform its duties in respect to reasonable rates, undue discriminations and favoritism, it must be informed as to the business of the carriers by a system of accounting which will not permit the possible concealment of forbidden practices in accounts which it is not permitted to see and concerning which it

¹ See *Williams v. Standard Oil Company*, 278 U. S. 235, and cases there cited.

can require no information. It is a mistake to suppose that the requiring of information concerning the business methods of such corporations, as shown in their accounts, is a regulation of business not within the jurisdiction of the Commission, as seems to be argued for the complainants. The object of requiring such accounts to be kept in a uniform way and to be open to the inspection of the Commission is not to enable it to regulate the affairs of the corporations not within its jurisdiction, but to be informed concerning the business methods of the corporations subject to the act that it may properly regulate such matters as are really within its jurisdiction. Further, the requiring of information concerning a business is not regulation of that business.

* * * * *

The report in controversy, as to business other than commerce, required a general description of such outside operations, and also a statement of the income from and the expenses of the same. As we have said, if the Commission is to be informed of the business of the corporation, so far as its bookkeeping and reports are concerned, it must have full knowledge and full disclosures thereof, in order that it may ascertain whether forbidden practices and discriminations are concealed, even unintentionally, in certain accounts and whether charges of expense are made against one part of a business which ought to be made against another.

The authority to require disclosure in the Goodrich case was qualified by the court in *Terminal Taxicab Co. v. District of Columbia*, 241 U. S. 252, where the District Public Utilities Commission sought jurisdiction over the taxicab company and information concerning all its business including its garage business. The court held that the company was subject to jurisdiction but that the order was too broad and that the company was not bound to give information as to its garage rates. The opinion states that there was no such connection between the charges for the garage and the cab service as there was between the facts required and the business controlled in the Goodrich case.

To the extent, therefore, of ascertaining if there is concealment of forbidden practices, statutory authority may be given a commission to require disclosure from a utility of information, even pertaining to things over which the commission does not otherwise have jurisdiction. So with this power, coupled with that permitting it to question exorbitant expenses or unconscionable contracts affecting the public service, and to regulate in the particulars which have been enumerated the property and business of a utility, the public interest would

seem to be protected. Holding companies not directly serving the public do not appear to fall within the classification of those subject to regulation, and dealings between such companies and operating utilities ordinarily may be reached only through the latter.

A tendency, however, has recently appeared in decisions of the courts having the effect of circumventing the principle that property is subject to regulation only when affected with a public interest. The method is to disregard the corporate entity of the operating company and to treat the operating and holding companies as one. It is being taken advantage of in recommendations for legislation with respect to this type of regulation. The report of the committee on intercorporate relations of the National Association of Railroad and Utilities Commissioners at the 1928 and 1929 sessions criticized what they called the holding company method of control, and recommended legislation giving state commissions jurisdiction over such companies. The 1929 report states that the committee believes it is possible for most state commissions to regulate a holding company which exercises control of management and operation of an operating company "by regarding the two as one and the same—in other words, by disregarding the corporation fiction." The report continues that much of the difficulty lies in the fact that many of the states have not assumed to exercise the obvious powers which they possess over such companies.

The first important case showing this tendency was *Ohio Mining Company v. Public Utilities Commission*, 140 N. E. 143, decided in 1922. The mining company filed a complaint before the Ohio Public Utilities Commission against the Southern Ohio Power Company and two of its subsidiaries, alleging that rates paid by the mining company for electric power were unreasonable. The commission held that the Southern Ohio Power Company, which sold its entire output to its two subsidiaries, was not a public utility and appeal was taken from that finding before the commission had made its finding with respect to the rates complained of. The Ohio Supreme Court reversed the commission on the ground that the property of all three corporations was owned by the stockholders of the power company; that the earnings and losses of each company inured

to or fell upon the same persons; that the separate ownership of the producing company (the holding company) and the distributing companies (the subsidiaries) was but a fiction and that there was in fact a single ownership of all. The effect, as stated by the court, was to withhold by a fiction one of these properties from the operation of the law as to public utilities which, but for the separate organization, would be subject thereto; that the owners sought by resort to the fiction of corporate ownership to limit the effect of dedication of the properties of their distributing companies to those companies alone, and that by reason of the fact that the whole was but one commonly owned property, engaged in a single enterprise, the act of one nominal division thereof was attributable to all. The court held that the power company was engaged in selling electric energy to consumers within the meaning of the public utility act and was subject to the jurisdiction of the commission.

A sequel to this decision is found in *Southern Ohio Power Company v. Public Utilities Commission of Ohio*, 143 N. E. 700, decided in 1924. Following the earlier case the power company did not file its tariff with the commission and an administrative order was made directing it to do so. The company, as its defense, showed that subsequent to the former decision it had divested itself of its holdings of stock in its two subsidiaries, the stock having been sold to individuals who were then stockholders of the power company. The court held that since the dedication to public use of the property of the power company found in the former case was unintentional by reason of the stock ownership of the operating companies, the divestment of stock control by the power company deprived it of its public utility character and left only the two subsidiary companies public utilities. The commission was reversed and the power company was held not to be a public utility. It is thus seen that the entire ground for the court's original holding that the power company was a public utility was based upon the ownership of stock of the distributing companies and not upon the fact that the entire output of the power company was sold to the distributing company, and without regard to what prices were charged the latter or the effect upon the public.

The next case of importance with respect to disregard of the

corporate entity was *Costan v. Manila Electric Company*, 24 Fed. (2d) 383, decided in 1928. Suit was brought to recover damages for personal injuries through negligent operation of a street railway car in Manila, Philippine Islands. The defendants were four corporations—Manila Electric Company, Manila Electric Corporation, J. G. White & Co. Inc., and the J. G. White Management Corporation. The facts show that the Manila Electric Corporation was a holding company, owning all of the capital stock of the Manila Electric Company, the corporate entity owning the railway property. The court held the holding company liable on the ground that the contract between the holding company and the operating company showed that the former disregarded the operating company as a distinct corporate entity and dealt with the properties and their operation exactly as though the legal title were in the holding company. The decision undoubtedly turned upon the nature of the contract and the practice of the holding company in itself assuming the active management which ordinarily would be undertaken by the operating subsidiary. It is distinguished by Judge Learned Hand in *Kingston Dry Dock Co. v. Lake Champlain Transportation Co.*, 31 Fed. (2d) 265, which will be discussed a little later.

The most recent case showing the tendency referred to is *People ex rel. Potter, Attorney General, v. Michigan Bell Telephone Company*, 224 N. W. 438, decided in 1929. The Attorney General filed an information to oust the Michigan Bell Telephone Company, a Michigan corporation, of its franchise. It was an attack on the so-called 4½ per cent (later four per cent) contract. The stock of the Michigan company was held by the American Telephone and Telegraph Company and a contract was entered into between the two companies providing for payment by the subsidiary of four per cent of gross earnings to the holding company. It was alleged that the holding company, through ownership of the stock and through domination of its subsidiary, was itself conducting business in the state. The information averred that "the Michigan Company is not conducting and carrying on telephone business in Michigan; the American Company is doing it." The decision states that a review of the evidence was convincing that the Michigan subsidiary was merely an oper-

ating unit and that it was no more engaged in conducting and carrying on a telephone business than is the ordinary station agent engaged in conducting and carrying on the railroad business of his employer. The court held that the Michigan company was a mere agent or instrumentality of the American company and that it was apparent that the purpose of the separate entity was to avoid full investigation and control by the state commission, to the injury of the public; that the difference in entity going out, the contract goes with it; the American company cannot contract with itself. The judgment was that the defendant be ousted of right to have credit in a computation of rates for payments to the American company under the contract.

While these decisions that the corporate entity should be disregarded and that the holding company and the operating company should be treated as a unit are recent, it is interesting to note a decision of the Supreme Court of the United States in 1918 which held to the same effect. This was the case of *Chicago, Milwaukee & St. Paul v. Minneapolis Civic and Commerce Association*, 247 U. S. 490, where complaint was brought against three roads, the Chicago, Milwaukee & St. Paul, the Chicago, St. Paul, Minneapolis & Omaha and the Minneapolis Eastern, alleging that the extra charge of \$1.50 per car for inbound cars delivered by the two trunk lines to the Minneapolis Eastern, their subsidiary, was unreasonable and should be abolished. The stock of the Minneapolis Eastern was equally owned by the other two roads. The court held that the operating company, the switching line, was under the entire control and management of the holding companies and that the latter exercised their power as stockholders to immediately and directly control the property and the conduct of business of the switching line. The decision states that the contract between the holding companies and the operating company evidenced an obvious surrender by the Eastern Company of substantially all freedom of corporate action and an assumption of control over that company by the Milwaukee and Omaha companies which converted the Eastern Company into a mere agency or instrumentality. The court stated that it was sheer sophistry to argue that because the Eastern Company was technically a separate legal entity it was an inde-

pendent public carrier, free in the conduct of its business from the control of the two companies which own it and therefore free to impose separate carrying charges upon the public. After reviewing prior decisions holding that ownership alone of capital stock in one corporation by another does not create an identity of corporate interest between the two companies or render the stockholding company the owner of the property of the other or create the relation of principal and agent between the two, the decision states that while the statements of law thus relied upon were satisfactory in the connection in which they were used, they have been repeatedly held not applicable where stock ownership has been resorted to, not for the purpose of participating in the affairs of a corporation in the normal and usual manner but for the purpose of controlling a subsidiary company so that it may be used as a mere agency or instrumentality of the owning company.

This decision of the Supreme Court may seem to indicate that its position on this phase of the situation is not unlike that of the courts in the recent decisions just reviewed. But the Minneapolis holding was predicated entirely upon the nature of the contract between the three companies. The contract and the carrying out of its terms were the determining factors.

In other cases the Supreme Court has unequivocally held that the corporate entity of a subsidiary must be respected. In *Pullman Car Company v. Missouri Pacific Co.*, 115 U. S. 587, decided in 1885, the court held that the Missouri Pacific Company, which owned all the stock of the St. Louis, Iron Mountain & Southern Company, had no control over the management of the latter. It pointed out that the Iron Mountain Company kept up its own organization, had its own officers and made its own bargains; that the Missouri Pacific Company, through its stock ownership, could determine who should constitute the subsidiary's board of directors but that there the power over the management of the subsidiary stopped; that the subsidiary was in no legal sense controlled by the holding company. The court said that by the stock ownership the holding company had all the advantages of control of the subsidiary, but that was not in law the control itself; that the stockholders of the corporation, while in a sense owning the property, were not the managers of its business or in the

immediate control of its affairs; that the rights and powers of the holding company were those of a stockholder only and that it (the holding company) was not the corporation (the subsidiary) in the sense of that term as applied to the management of the corporate business or the control of the corporate property.

This case was followed in *Peterson v. Chicago, Rock Island & Pacific Ry. Co.*, 205 U. S. 364, where legal process against a foreign holding company was served on an agent of the local subsidiary in Texas. The court recited that the subsidiary and the holding company had common agents and employees to a certain extent but that they were paid in proportion to the business done for each company and their services were kept distinct and separate. It was then stated that the holding of the majority interest in the stock does not mean the control of the active officers and does not make the holding company the company transacting local business. And in *Rhode Island Trust Co. v. Doughton*, 270 U. S. 69, where jurisdiction of the R. J. Reynolds Tobacco Co., a New Jersey corporation, was sought in North Carolina on an estate tax based on the ground that two-thirds of the corporation's property was situated in North Carolina, the court said:

This is on the theory that the stockholder is the owner of the property of the corporation, and the State which has jurisdiction of any of the corporate property has *pro tanto* jurisdiction of his shares of stock. We can not concur in this view. The owner of the shares of stock in a company is not the owner of the corporation's property.

In January, 1930, the District Court held in *Illinois Bell Telephone Co. v. Moynihan*, 38 Fed. (2d) 77, that ownership of ninety-nine per cent of the stock of the Illinois company by the American Telephone & Telegraph Co. did not render the latter subject to the Public Utilities Commission with respect to rates. The city of Chicago contended that the American company had exercised its control in such a way that the corporate identity of the Illinois company was destroyed, and that the question to be determined was as to the fair return to the investors in the American company, the real operator of the property. The court held that the stock ownership gives the American company power to control the Illinois company

through the election of directors, but that this does not make the former the one which is operating the local utility nor destroy the separate corporate identity of the local company; that the stock ownership does not give authority to dictate the acts of the directors of the local company, and that they will be presumed to have performed their official duties honestly and to have acted in good faith with respect to the corporation of whose affairs they are in charge and the public to which it gives service, citing *Pullman v. Missouri Pacific*, *Peterson v. Rock Island*, and other cases. The District Court then said that courts will, of course, look through form to substance, and referred to cases in which there may be a commingling of affairs of the holding and operating companies having the effect of making them practically one.

This commingling of affairs has been treated in the several decisions of the Supreme Court with respect to the commodities clause. They point out a distinction between mere stock ownership and active control by the holding company. In *United States v. Lehigh Valley R. R. Co.*, 220 U. S. 257, decided in 1911, the government contended that the railroad company was not only the owner of all the stock of the coal company but that the railroad company so used the power thus resulting from its stock ownership as to deprive the coal company of all real independent existence and to make it virtually an agency or dependency or department of the railroad company. The court held that the effect alleged in the appeal was not the necessary result of a *bona fide* exercise of stock ownership and could only have arisen through the use by the railroad of its stock ownership for the purpose of giving the latter, as a corporation for its own corporate purposes, complete power over the affairs of the coal company just as if the latter were a mere department of the railroad; and that such a situation could not have existed had the fact that the two corporations were separate and distinct legal entities been regarded in the administration of the affairs of the coal company. In conclusion, the court said that while the right of a railroad company as a stockholder to use its stock ownership for the purpose of a *bona fide* separate administration of the affairs of a corporation in which it has a stock interest may not be denied, the use of such stock ownership in substance for the purpose of destroy-

ing the entity of the coal company and of commingling its affairs in administration with the affairs of the railroad so as to make the two corporations virtually one, brings the railroad company within the prohibition of the commodities clause.

To the same effect was the holding in *United States v. Delaware, Lackawanna & Western Railroad*, 238 U. S. 516, decided in 1915. The court held that mere stock ownership by a railroad company in a producing company was not the test of illegality under the commodities clause but unity of management and *bona fides* of the contract between the companies, and that the two companies should studiously and in good faith avoid anything, either in contract or conduct, that remotely savors of joint action, joint interest or the dominance of one company by the other.

In *United States v. Reading Company*, 253 U. S. 26, decided in 1920, the court said that it may confidently be stated that the law upon this subject now is that while the ownership by a railroad company of shares of stock of a mining company does not necessarily create an identity of corporate interest between the two, such as to render it unlawful under the commodities clause for the railroad company to transport the products of the mining company, yet where such ownership of stock is resorted to, not for the purpose of participating in the affairs of the corporation in a manner normal and usual with stockholders, but for the purpose of making it a mere agent or instrumentality of another company, the courts will look through the forms to the realities of the relation between the companies as if the corporate agency did not exist.

The Reading decision also cites *Northern Securities Company v. United States*, 193 U. S. 197, in support of the statement that the subsidiaries were mere agents or instrumentalities of the holding company and that the latter served to pool the properties, the activities and the profits of the three companies. The Northern Securities case was brought under the Sherman Anti-Trust Act, and in discussing the effect of the corporate organization the court said that the stockholders of the two competing companies disappeared, as such, for the moment, but immediately reappeared as stockholders of the holding company, which was thereafter to guard the interests of both sets of stockholders as a unit and to manage both lines

of railroad as if held in one ownership; that necessarily by this combination or arrangement the holding company in the fullest sense dominated the situation, "as much so, for every practical purpose, as if it had been itself a railroad corporation which had built, owned and operated both lines for the exclusive benefit of its stockholders." The court then went on to point out the effect of this situation upon competition and the restraint of trade which was, of course, the vital point under consideration.

The Northern Securities case was followed in *United States v. Southern Pacific Company*, 259 U. S. 214, decided in 1922, in support of the statement that such combinations, not the result of normal and natural growth or development, but springing from the formation of holding companies, or stock purchases, resulting in the unified control of different roads or systems, constitute a restraint upon freedom of commerce. This again was an anti-trust case where the effect of holding companies was considered with relation to the prevention of competition. The Supreme Court directed a decree severing control by the Southern Pacific of the Central Pacific by stock ownership or lease and remanded the case to the District Court. The latter, in its decision rendered in 1923,¹ pointed out that in the former proceeding before the Supreme Court no reference had been made to the Transportation Act of 1920, and stated that subsequently the Southern Pacific Company had filed an application with the Interstate Commerce Commission for authority to acquire control of the Central Pacific by lease and ownership of all of the capital stock. The commission issued an order permitting such control which the District Court sustained. The government did not appeal. The effect of the Transportation Act as a new departure is thus seen, and control through stock ownership once held unlawful is now permitted. So the broad condemnation by the Supreme Court in the Northern Securities case, that the holding company dominates the situation as much as if it had been itself a railroad corporation owning and operating the property, is qualified by the effect of subsequent legislation and court decisions.

On the same day that the Supreme Court decided the South-

¹ *United States v. Southern Pacific Co.*, 290 Fed. 443.

ern Pacific case it handed down its decision in *Houston v. Southwestern Bell Telephone Company*, 259 U. S. 318. The decree of the District Court enjoining enforcement of an ordinance prescribing rates was affirmed. Leasing of telephone instruments from the American Telephone and Telegraph Company was involved, and the city contended that no disclosure was made of the profits. The Supreme Court stated that evidence was introduced tending to show that the charge made for services rendered and supplies furnished was reasonable, and that the fact that the American company controlled the Houston company by stock ownership "is not important beyond requiring close scrutiny of their dealings to prevent imposition upon the community served by the company," and that the District Court recognized and applied this rule. On authority of this case a similar finding on the point of profits and contracts between the holding and operating companies was made by the District Court in the recent Illinois telephone case above referred to.

The Houston case was recently followed in principle in *United Fuel Gas Co. v. Railroad Commission of Kentucky*, 278 U. S. 300, decided in 1929. The gas company was a West Virginia corporation, selling to its subsidiary, a Kentucky corporation which was subject to the commission of that state. The court commented on the fact that the producing or wholesale part of the West Virginia company's business was not regulated, but that it did not appear that the ultimate distribution of its product to consumers would be immune from regulation. Referring to the contract between the companies, the decision states that common ownership is not of itself sufficient ground for disregarding such intercorporate agreements when it appears that although the affiliated corporation may be receiving the larger share of the profits, the regulated company is still receiving substantial benefits and probably could not have secured better terms elsewhere, citing the Houston case. But, stating that the instant case was not of that class, the court approved the finding of the lower court in including in the earnings of the regulated business 50 per cent of the net proceeds of the gas extraction business of the affiliated corporation notwithstanding the contract provided 12½ per cent, on the ground that the unregulated corporation was making a

profit of over 100 per cent. This further illustrates the principle that the necessities of regulation can be reached through the regulated company without jurisdiction over the unregulated affiliated corporation.

A very clear statement of the relations between parent and subsidiary corporations is contained in the opinion, previously mentioned, of the Circuit Court of Appeals in *Kingston Dry Dock Co. v. Lake Champlain Transportation Co.*, 31 Fed. (2d) 265, decided in 1929. The decree of the lower court holding the affiliated corporation liable was reversed, and after referring to the Manila case, Judge Hand said:

Control through the ownership of shares does not fuse the corporations, even when the directors are common to each. One corporation may, however, become an actor in a given transaction, or in part of a business, or in a whole business, and, when it has, will be legally responsible. To become so it must take immediate direction of the transaction through its officers, by whom alone it can act at all. [Citing cases.] At times this is put as though the subsidiary then became an agent of the parent. That may no doubt be true, but only in quite other situations; that is, when both intend that relation to arise, for agency is consensual. This seldom is true, and liability normally must depend upon the parent's direct intervention in the transaction, ignoring the subsidiary's paraphernalia of incorporation, directors and officers. The test is therefore rather in the form than in the substance of the control; in whether it is exercised immediately, or by means of a board of directors and officers, left to their own initiative and responsibility in respect of each transaction as it arises. Some such line must obviously be drawn, if shareholding alone does not fuse the corporations in every case.

It is thus seen that if a clear line of demarcation is drawn between the holding and operating companies, if the corporate management is kept separate, and if the holding company does not in fact direct the affairs of the operating company, no relationship exists warranting authority to regulate the former simply because the latter is subject to commission jurisdiction. The Supreme Court in the rate cases mentioned found nothing unlawful or improper on account of the local utility being controlled by a holding company. In the cases under the commodities clause, and in the Missouri Pacific and Rock Island cases, it points out the way to determine the relationship through stock ownership between controlling and controlled corporations.

It shows that the corporate entity is separate; that *bona fide* stock ownership for the purpose of participating in the affairs of the subsidiary corporation in a manner normal and usual with stockholders is not in law the control itself; that the holding company is not the manager of the subsidiary; but that the corporate entity may be broken down by contract and conduct having the effect of creating dominance in management by the holding company.

The Ohio case went much farther than this principle when it held that the mere fact of stock ownership caused the earnings and losses to inure to and fall upon the same persons; that separate ownership of the several corporations in the group was but a fiction; that there was in fact a single ownership, and that by reason of this the act of one nominal division was attributable to all. This is not the law as laid down by the Supreme Court, and the recommendation of the committee of the National Association to disregard the corporate fiction is susceptible of misconstruction and unsound action. The test prescribed by the Supreme Court is whether the ownership of stock by the holding company is resorted to for the purpose of making the subsidiary a mere agent or instrumentality or department, and of so commingling the affairs of administration as to make the two companies virtually one, and if so the court will look through the forms to the realities of the relations between the companies as if the corporate agency did not exist. It is only in such instances that the so-called corporate fiction may be disregarded.

The contract is the usual weakness. This, and the conduct between the companies, as stated in the Lackawanna decision, should not remotely savor of joint action, joint interest or the dominance of one company by the other. If this point is observed, mere ownership of stock exercised in a normal and usual manner in no legal sense effects control in the sense of management. In the Michigan Telephone case the court found that the difference in entity going out, the contract goes with it. This was treating the contract as the result, not the cause. But the court was influenced by statements in the annual report of the holding company, outlining the relationship of the subsidiaries to the central organization. The report stated that each was an operating division and no more

The evidence also quoted a statement of the chairman of the board of the holding company to the directors at the time of organization of the subsidiary, explaining the reasons for such organization, one of which was the regulation of rates by state commissions and the fact that local companies seemed to be in more favorable position. This elicited the court's finding that the purpose of the separate entity was to avoid full investigation by the state commission.

In none of the Supreme Court decisions referred to has the question of commission regulation of holding companies been involved. Where the corporate entity is respected and no direct management exists there can be no property of the holding company affected with a public interest so as to be subject to regulation unless the holding company is itself engaged in public service. Even in circumstances where the corporate entity should be disregarded it seems improbable that there would be found such merging of the property that the whole had become affected with a public interest. The Northern Securities decision came the nearest to declaring this principle, but that was under a criminal statute as distinguished from one providing for regulation, and the application of the law has since been changed.

Even if it be considered that the need exists for regulation of holding companies, the question arises as to how they may be reached if not within the jurisdiction of the commission seeking such authority. If the holding company is a domestic corporation the situation may be simplified, but if it is a foreign corporation with no agent in the state, how is the commission going to require reports, examine books and records and carry out other regulatory provisions applicable to utilities doing business within the state? The commission has no means of enforcing its jurisdiction. It cannot serve its order on the holding company in the first instance, to say nothing of requiring the order to be carried out.

A bill designed to regulate holding companies, considered but not passed at the 1929 session of the Maryland legislature, attempted to overcome this difficulty by providing that if the holding corporation shall have relations in respect of which it is subject to the jurisdiction of the commission without having an agent appointed in the state, such corporation shall be

deemed to have appointed the Secretary of the State Tax Commission its attorney upon whom legal process may be served, provided the Public Service Commission shall send a copy of such notice to the last post office address of the corporation. The intention apparently was to apply the principle of constructive appointment discussed in the case of *Wuchter v. Pizzutti*, 276 U. S. 13. That case had reference to a statute which provided that where a non-resident operated an automobile within the state and injured a citizen of the state, the citizen could secure service on the non-resident by service on the Secretary of State. The court held the statute invalid because it failed to make reasonable provision for notice of the suit to be given the non-resident. The Maryland bill made such provision, but there appears to be a marked difference between the voluntary act of a non-resident running an automobile in the state and enjoying its facilities and privileges, and the act of a foreign corporation in owning shares of stock of a public utility doing business within the state, and it is doubtful if the principle of the *Wuchter* case would be held applicable to a non-resident holding corporation. In the Michigan telephone case the holding corporation was not before the commission or the court. The proceeding was to oust the local utility, a corporation of the state, and the court simply held that it be ousted of right to have credit in a computation of rates for payments made to the holding company.

The Supreme Court in the *Rock Island* case, again mentioned, held that service on an agent of the subsidiary did not effect service on the parent corporation. In *St. Louis-Southwestern Ry. v. Alexander*, 227 U. S. 218, and in *Philadelphia & Reading Ry. v. McKibbin*, 243 U. S. 264, the court held that service was not effective unless the corporation was engaged in business in the state of such character and in such manner and to such an extent as to bring itself within the jurisdiction so that service upon an agent directly representing the authority of the corporation would constitute reasonable notice.

Transaction of business in a state by a subsidiary does not bring the parent corporation within the state's jurisdiction. This has been unequivocally stated in *Cannon Mfg. Co. v. Cudahy Co.*, 267 U. S. 333. It was charged in that case that the parent dominated the subsidiary, and the Supreme Court

held that although the identity of interest may have been more complete and the exercise of control over the subsidiary more intimate than in other cases, that fact in the absence of an applicable statute had no legal significance, and the question was simply whether the corporate separation carefully maintained must be ignored in determining the existence of jurisdiction. The court held that it could not be ignored, and that the business of the subsidiary was not the business of the holding company.

In following the Cannon case the Circuit Court of Appeals in *Selbert v. Lancaster Chocolate & Caramel Co.*, 23 Fed. (2d) 233, points out details of corporate relations which were held not sufficient to overcome lack of jurisdiction. The court said:

In the present case, the facts that the boards of directors of the foreign and domestic corporations were interlocking, that officers of the foreign corporation occupied relatively the same offices in the domestic corporations, that the foreign corporation was vitally interested in the success of the domestic corporations, or even that the foreign corporation was specifically organized to acquire and hold stock in the domestic corporations and through stock ownership to supervise, manage and control the business of such domestic corporations, or all combined, are insufficient to support the inference that the foreign corporation has subjected itself to local jurisdiction, or that it is by its duly authorized officers and agents here present.

The cases cited hold that ownership of stock does not constitute doing business. The effect seems apparent also that ownership of stock in a company engaged in interstate commerce does not make the holding company similarly so engaged.

The principles applicable to jurisdiction present practical difficulties to be surmounted before many of the plans suggested for regulation could be made effective. But entirely apart from the jurisdictional question, the need claimed to exist for the regulation of all holding companies is doubtless more fanciful than real. In the case of a holding company with investment features only, referred to in the third class earlier mentioned, which exercises its ownership of stock in the usual and normal way, there is nothing in the relation between the holding company and the subsidiary which could directly or indirectly affect the rates or service of the operating com-

pany. Such a holding company owns no property affected with a public interest, sells nothing to consumers, furnishes no service to the public, and the relations of the operating company to the public are unaffected by the fact that its stock is owned in whole or in part by the holding company.

Those companies of the second class who sell or lease apparatus or other supplies, or who sell their entire output produced to operating companies, ought not to be considered subject to regulation. They sell to their subsidiaries, not to the public. If the prices paid by the operating company are unreasonable the regulating commission has power to ascertain the facts and to require the exclusion of unreasonable amounts from expenses and a corresponding modification of net income. Disclosure of information for such purposes may be required from the operating utility.

Management companies or those where there is a quasi-operating relationship with some measure of supervision, within the first class, are in the most difficult position. In such cases, if there is dominance by the holding company, or if the contract and conduct of operations make applicable the rule respecting disregard of the corporate entity, arguments in favor of regulation seem difficult to overcome. The sale of securities and financial dealings between companies of this class involve problems causing much concern. But supervision of security issues is already possessed by many commissions, and it has been exercised in denying issuance and sale to holding companies. Possibly some further details of regulation can be worked out on this phase of the subject to relieve apprehension.

Indiscriminate efforts to extend regulatory powers, without distinguishing between properties affected with a public interest and those which are not, and without a clear understanding of corporate relationships which must be respected, are likely to result only in an increased number of reports, prolific accounting requirements and attempted enforcement of orders without jurisdiction, which will be burdensome to the companies and valueless to the commissions. Application of the principles stated in the decisions here reviewed to the method of corporate structure and its administration, to the making and carrying out of contracts and to the conduct of all affairs be-

tween holding companies and subsidiaries may serve to clarify the situation.

To present the results of a minute examination of all court decisions and economic factors bearing on the subject has not been possible in this discussion. Sufficient probably has been stated to show the broad extent of present provisions for regulation of operating companies and to indicate false trends of some of the recent decisions on which are based unsound recommendations for regulation of holding companies. The decisions reviewed show that many of the questions about which confused thought exists have been settled. On the basis of these principles it does not seem an impossible task to determine methods which will accomplish the desired result—protection of the public interest without curtailing the effectiveness of the public service.

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STATE CONTROL OF INTERSTATE POWER TRANSMISSION—THE DOCTRINE OF CONGRESSIONAL PERMISSION

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MY part in this discussion has to do with the constitutional aspects of power control—not those relating to due process, but those concerning the commerce clause and its bearing upon state regulation. Mr. Goldberg has discussed the interstate problem and has expressed a positive view against congressional action in the interstate area.¹ It is not my purpose to debate the issue of policy as between federal and state control. On the contrary, what I have to say rests upon an assumption (and it is nothing but an assumption) that as a matter of policy the states should control the industry. There then arises the question what the Congress can do to enable the states to exercise a full and effective control, even where interstate commerce is involved. What I have to say on this question is by way of introduction to and summary of a paper prepared by Mr. William C. Scott,² indicating something of the results of a study in progress in the School of Law of Columbia University on the general subject of "State and Federal Control of Power Transmission as Affected by the Interstate Commerce Clause". Three phases of the matter should be considered:

I. *The Extent of Interstate Transmission of Power.*

In 1926 interstate transmission amounted to over six billion kilowatt-hours, or 9.06 per cent of the total power generated in the United States. In 1928 it had increased to almost nine billion kilowatt-hours, representing 10.7 per cent of the total. From 1926 to 1928 the total production of power increased some fifteen billion kilowatt-hours, and almost a fifth of this

¹ Cf. *supra*, pp. 101-107.

² Cf. *infra*, pp. 135-56.

increase was represented by power transmitted across state boundaries. The Federal Trade Commission at the request of the Senate is now engaged in compiling figures for 1929, and in a preliminary report records a further great increase for that year. From the standpoint of extent, then, interstate transmission is of substantial importance.

II. *The Present Legal Status of Interstate Transmission.*

Transmission in wholesale quantities has been declared by the Supreme Court in the *Attleboro* case (this case and others presently to be mentioned will be cited and discussed in Mr. Scott's paper¹) to be interstate commerce national in character and beyond the regulatory power of the states, even in the absence of congressional action. Retail transmission and distribution, on the other hand, still remain, under the authority of the *Pennsylvania Gas* case, subject to state jurisdiction until Congress acts. Consequently, at least in so far as wholesale interstate transmission is concerned, Congress not having occupied the field and the states being unable to occupy it, there is at present an uncontrolled area. Mr. Scott's paper does not indicate and I am unable to say whether this area is in fact altogether unregulated; for it may be that the utilities acquiesce in state regulation which they could successfully resist. Such acquiescence would not be surprising if it appeared that the utilities are generally opposed to federal control. It is not clear just how much of an administrative problem has been raised as a result of the decision in the *Attleboro* case. But the constitutional problem remains none the less. Hence we come to the question, whether there is anything Congress can do to enable the states to reach, even against resistance by the utilities, such phases of the business as that illustrated in the *Attleboro* case.

III. *The Doctrine of Congressional Permission for State Action.*

The answer to the question just stated is to be found in a doctrine of great constitutional significance developed by the Supreme Court in the interpretation of the commerce clause. Eighty years ago the court announced a division of interstate

¹ Cf. *infra*, pp. 138-39.

commerce into two categories: the first, national in character and requiring uniformity of regulation, over which the power of the states is inoperative even in the absence of legislation by Congress; and the second, local in character, over which the states may exercise authority until Congress acts. It is with the former that we are concerned. There the court says that when Congress does not act it indicates by its silence that such commerce shall remain free from state control. The implication is that Congress can break its silence and affirmatively express its will that such commerce be subject to control by the states. This is precisely what Congress has done in the Wilson and Webb-Kenyon acts, relating to the interstate transportation of intoxicating liquors; and both of these have been sustained by the Supreme Court. Nor has congressional permission of this character been restricted to liquors. As Mr. Scott shows, it has been given in different forms and in respect of different subjects from 1790 to the present day.

This doctrine of congressional permission runs about as follows. The states possess their "police power". But the states cannot use it to regulate interstate commerce national in character; for the commerce power of the Congress is superior and Congress, by its silence, forbids the states to act. However, by affirmative legislation Congress can overcome this implication, and permit the states to exert their power. So, with the assumption that state regulation is preferable to federal, the cases indicate that Congress can remove the commerce clause obstacles standing at present in the way of complete control by the states.

STATE AND FEDERAL CONTROL OF POWER TRANSMISSION AS AFFECTED BY THE INTERSTATE COMMERCE CLAUSE

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I

INTERSTATE transmission of power is now an important phase of the industry, and it presents one of the chief problems to be dealt with in effecting adequate public control. A few statistics will suffice to show the amount and relative importance of this new and indispensable "interstate commerce".¹

The first comprehensive survey of the interstate transmission of power was made under the auspices of the Harvard School of Business Administration.² The figures compiled were for 1926, and the material was gathered through questionnaires sent out to the various power companies. It is shown that for 1926 the total power generated in the United States was 68,145,217,000 kilowatt-hours. Of this amount the total quantity transmitted across state lines aggregated 6,171,530,837 kilowatt-hours, exclusive of power crossing the Canadian and Mexican borders. Thus the power transmitted across state boundaries amounted to 9.06 per cent of the total power generated—a rather small percentage when considered relatively, but by no means so in the absolute. Also, it should be noted that in this survey it was not found feasible to obtain figures showing the power entering interstate transmission by

¹ Interstate transmission of electric power was specifically held to be "interstate commerce" within the meaning of the commerce clause of the Constitution by the U. S. Supreme Court in *Public Utilities Commission of Rhode Island v. Attleboro Steam and Electric Co.*, 273 U. S. 83 (1927).

² *Interstate Transmission of Power by Electric Light and Power Companies in 1926*, Bulletin No. 68, Bureau of Business Research, Harvard University, 1927.

means of railroads, street railways, industrial enterprises, and the United States government.

In 1926 about half (twenty-five) of the states exported between .001 and 10 per cent of the electric power generated within their borders, and six exported no energy whatsoever. Of the remaining states, however, twelve exported between 10 and 20 per cent, and five from 20 to 50 per cent, while Idaho and Vermont exported 63 and 92 per cent respectively.

The import figures are equally impressive. Twenty-five states imported between .001 and 10 per cent of the power generated within their borders. Four imported no power whatever. But of the other states eight imported from 10 to 20 per cent, and four from 20 to 30 per cent, while Maryland imported 74.7 per cent and Mississippi 98.1 per cent. Three states, Missouri, Utah and Nevada, imported more power than they themselves generated.¹

No figures on interstate transmission were compiled for the year 1927, and the next survey we have is for 1928.² A remarkable growth in interstate transmission during the intervening two years is shown. The survey for 1928 is modeled along precisely the same lines as that for 1926, and consequently there is a good basis for a comparison of figures.³

During 1928 the country's total consumption⁴ of electricity reached 83,147,000,000 kilowatt-hours, exclusive of energy imported from Canada. Of this, 8,920,000,000 kilowatt-hours, or 10.7 per cent, represented interstate transmission. Thus, in two years the percentage of interstate transmission rose over 1 per cent. This of itself does not seem impressive, but when analyzed further the increase is really of important dimensions. In the first place, the mere fact that over eight billion kilowatt-hours passed over state lines in 1928 marks

¹ Also see Mosher, *Electrical Utilities* (1929), pp. 130, 131.

² *Interstate Transfer of Electric Power in 1928*, Statistical Bulletin No. 4, National Electric Light Association, 1929.

³ The tables of statistics are followed, and the interstate transmission by means of railroads, street railways, industrial enterprises, and the U. S. government is likewise omitted.

⁴ It will be noticed that in the 1928 survey the basis of computation is "consumption" of power, while in that of 1926 the basis is "generation". However, in the former the terms are used interchangeably, so the difference seems to be unimportant.

this phase of electric power as a major industry in itself. In the second place, of the increase in all power transmission from 1926 to 1928, the interstate part represents almost 17 per cent.¹ It is also significant to note the increase in the number of interstate power lines. In 1928 there were listed 510 such lines. Compared with the figure for 1924 this represents an increase of 45 per cent.²

And now the Federal Trade Commission, in response to a resolution recently passed by the Senate,³ is engaged in the compilation of interstate power figures for the year 1929. In a preliminary report to the Senate⁴ the Commission reports that a very considerable increase in interstate transmission was recorded during the past year, in comparison with the figures for 1928. It is implied that the growth for 1929 is much greater than that for any previous year, although no definite figures have yet been submitted.

It can readily be seen from the foregoing statistics, that interstate transfer of power has assumed major proportions. And its future growth will be even more rapid, with the rising demand and the increased facilities for high-tension transmission.

II

Control by the states of this newest form of interstate commerce has been restricted, and the situation thus created will be found to leave a gap in the regulation of one of the most important of the public utility enterprises.

Control over a public utility usually centers in the regulation of rates. Accordingly, we may ask ourselves how far the fact that the power is transmitted across state lines limits the authority of the states to regulate the rates. Roughly speaking, interstate transmission falls into two categories. One is what we might call wholesale transmission; in this case the power is transmitted by a generating company across state lines to a

¹ Total consumption of power during this period increased about 15,000,000,000 kilowatt-hours, while interstate transmission increased 2,500,000,000 kilowatt-hours.

² See Mosher, *op. cit.*, p. 131.

³ Senate Resolution 151, 71st Congress, First Session.

⁴ *Interim Report on Interstate Movement of Electric Power*, Federal Trade Commission, submitted March 10, 1930.

distributing company, which in turn sells to the consumer. Such transmission is naturally in wholesale quantities. The other might be called retail transmission. Under this classification we have transmission by a generating or distributing company in one state directly to consumers in another state.

State authority to regulate rates of wholesale interstate transmission of power has been definitely nullified by the Supreme Court of the United States in a case which squarely presented the question.¹ The Narragansett Company, a Rhode Island corporation, manufactured electric power at its plant in Providence and sold a part of it under contract to the Attleboro Company, a Massachusetts corporation, which was a distributing company, selling the current thus obtained to its own customers in Massachusetts. Delivery of the power was made at the state line. The Narragansett Company applied to the Rhode Island Public Service Commission for an increase in rates of such a nature as to be applicable only to the power sold to the Attleboro Company. The commission allowed the increase, but the Supreme Court of Rhode Island reversed the order. The case went up to the United States Supreme Court on writ of *certiorari*. There it was held that the State of Rhode Island had no jurisdiction over the rates charged to the Attleboro Company, since such a regulation would have the effect of placing "a direct burden on interstate commerce".

The order . . . is not . . . a regulation of the rates charged to local consumers, having merely an incidental effect upon interstate commerce, but is a regulation of the rates charged by the Narragansett Company for the interstate service to the Attleboro Company, which places a direct burden upon interstate commerce. Being the imposition of a direct burden upon interstate commerce, from which the state is restrained by the force of the commerce clause, it must necessarily fall, regardless of its purpose.²

There can be no doubt that this decision has placed regulation of wholesale transmission as to rates entirely beyond the jurisdiction of the states.

As to retail transmission the result has been different.

¹ *Public Utilities Commission of Rhode Island v. Attleboro Steam and Electric Co.*, 273 U. S. 83, 47 Sup. Ct. 294 (1927).

² Quoted from majority opinion, per Justice Sanford.

Although there is no Supreme Court case which has considered such transmission with reference to electric power, there has nevertheless been a ruling upon it as applied to natural gas, which the Supreme Court evidently deems analogous to power in such a situation.¹ In *Pennsylvania Gas Co. v. Public Service Commission of New York*,² the United States Supreme Court had before it the question of the validity of an order by the New York Public Service Commission directing the Pennsylvania Gas Company to reduce its rates to consumers. The gas company was a Pennsylvania corporation, and was engaged in transporting gas through pipe lines from its source in Pennsylvania over the state line into New York, there to sell it directly to local consumers. The jurisdiction of the New York commission was upheld, the court saying, in part:

The thing which the state Commission has undertaken to regulate, while part of interstate transmission, is local in its nature, and pertains to the furnishing of natural gas to consumers within the city of Jamestown, in the state of New York. . . . The service is similar to that of a local plant furnishing gas to consumers in a city.

This local service is not of that character which requires general or uniform regulation of rates by Congressional action, and which has always been held beyond the power of the states, although Congress has not legislated on the subject. While the manner in which the business is conducted is part of interstate commerce, its regulation in the distribution of gas to local consumers is required in the public interest, and has not been attempted under the superior authority of Congress.

The Attleboro and Pennsylvania Gas Company cases pretty squarely indicate the present situation in regard to state control. By virtue of the former wholesale interstate transmission and distribution are declared to be beyond the reach of state regulatory agencies, even though Congress has left the field unregulated. On the other hand, the latter case indicates that the states are free to exercise jurisdiction over interstate retail transmission so long as Congress chooses to leave the matter in their hands. Thus there is a gap in the

¹ The court in its decision in the Attleboro case (*cf.* p. 138, note 1) based its decision squarely on *Missouri v. Kansas Natural Gas Co.*, 265 U. S. 298 (1924), a case involving the transmission of natural gas under the same circumstances.

² 252 U. S. 23, 64 L. Ed. 434 (1920).

field of regulation, which leaves a section of interstate transmission free from any direct interference.

As to the actual extent and importance of the administrative and economic problems raised by the existence of this gap we are not prepared to be dogmatic. We are told that the amount of *wholesale* interstate transmission is at present negligible.¹ It might be that power companies engaged in interstate business would not raise technical objections to state jurisdiction, in order to minimize conflicts over regulation with their attendant unfavorable reaction on the public. However, the decision in the Attleboro case is of recent date.²

But aside from economic and administrative problems, the constitutional questions relative to the regulation of interstate transmission remain, and it is with that phase that we are here concerned. The fact is that federal control as a matter of policy has been advocated by some authorities,³ and a bill to establish such control is even now before the United States Senate.⁴ It appears that the existence of the gap in regulation which we have described is at least relied upon as one of the arguments to show the advisability of some form of federal control.⁵ In addition, the alleged breakdown of the present form of national control under the Federal Water Power Act,⁶ which control is at best very limited in scope,⁷ has been urged as necessitating a complete reorganization and extension of federal regulation.⁸

To advocates of national control of all interstate trans-

¹ See *Interstate Transfer of Power in 1928*. It is there stated that wholesale interstate transmission of power constitutes only 4.1 per cent of total transmission.

² The case was decided in 1927.

³ See Mosher, *op. cit.*, ch. iv, "Control of Interstate Transmission."

⁴ Senate Bill No. 6, 71st Congress, First Session, introduced by Senator Couzens, and popularly referred to as the Couzens Bill.

⁵ Mosher, *loc. cit.*

⁶ 41 U. S. Stat. at L. 1063 (1920).

⁷ Control is restricted to federal licensees conducting hydroelectric power projects on navigable rivers.

⁸ In recent hearings before the Senate Interstate Commerce Committee testimony has been given to the effect that regulation under the Federal Water Power Act has completely failed.

mission the constitutional path is fairly clear. There can be no doubt that Congress, in the exercise of its superior power under the commerce clause of the Constitution, can step in and subject the whole field to detailed federal regulation. Although the Couzens Bill ¹ does not fully deprive the states of their jurisdiction over the interstate phases of the power industry, ² its ultimate object is the establishment of superior federal control.

However, federal control as a policy seems to be far from popular, and against it serious objections have been raised. President Hoover himself has gone on record as opposing any plan which has as its object the defeat or curtailment of local control, ³ and many other experts apparently join in the view. ⁴ Just how extensive this attitude is, remains a question to be determined in the future.

In the event that opinion hostile to national control of interstate transmission prevails, the question arises as to whether there is any way in which Congress can legally place all such transmission within the jurisdiction of the states, and thereby fill in the gap which now exists. In other words, leaving out of consideration such plans as the creation of interstate compacts or the direct utilization of state agencies by the federal government, ⁵ can Congress, consistently with

¹ Cf. *supra*, p. 140, note 6.

² Par. *h* of the Bill provides in part: "Notwithstanding the foregoing provisions . . . nothing therein shall be construed to abridge the jurisdiction or authority of any state to regulate, to the same extent as if this Act had not been passed, the rates and charges for the sale to consumers within the state of any power transmitted in interstate commerce . . . unless a substantial number of the consumers of such power . . . file with the commission a petition requesting Federal regulation. . . ."

³ See address before the National Association of Railroad and Utilities Commissioners in 1925, *Proceedings*, pp. 262-271.

⁴ See report of the resolution unanimously adopted by the National Association of Railroad and Utilities Commissioners at their annual meeting, 1929, in which the Couzens Bill was condemned. Also see Gray, "The Dilemma of Giant Power Regulation", *Annals of American Academy of Political and Social Science*, vol. 129, p. 114.

⁵ For a discussion of these plans the reader should consult Mosher, *loc. cit.*; Gray, *loc. cit.*; and Anderson, "State Commissions as Regional Federal Commissions", National Association of Railroad and Utilities Commissioners, *Proceedings*, 1920, pp. 32-42.

the Constitution, pass legislation which would operate to permit the states to regulate interstate transmission, whether it be wholesale or retail? Such legislation would naturally be designed to overcome the effect of the decision in the *Attleboro* case.

It is not our object to criticize the policy of legislation of this type, since we are not concerned here with the economic soundness or administrative effectiveness of the plan. Such considerations must be determined by those best acquainted with the facts, namely, technical and administrative experts. What we do propose to do is to examine what we might term the constitutional basis for such legislation. Could the Supreme Court be looked to, in the final analysis, to uphold it?

III

The type of legislation suggested goes upon the theory that even though the United States Supreme Court has held a portion of the power which is transmitted across state lines to be beyond the jurisdiction of the states even in the absence of Congressional regulation, it is nevertheless possible for Congress by positive action to permit reasonable state regulatory laws to apply to such power. May Congress accomplish this purpose under the proper exercise of its constitutional power over interstate commerce? In order to answer such a query satisfactorily it is necessary to go into the judicial interpretation of the commerce clause, together with the history of similar legislation on the part of Congress.

The Constitution¹ confers upon Congress the power to regulate commerce "among the several states", but is not in terms specific, and does not deny the states power over the same subject matter. Consequently it has been left to the Supreme Court to define the respective spheres of the states and nation. Quite wisely, the court has not attempted to lay down any general, all-inclusive rules, but has "pricked out" its lines of demarcation as they appear to be demanded by the particular cases.

The commerce clause first came up for interpretation in the famous case of *Gibbons v. Ogden*,² which involved the power

¹ Article I, Sec. 8, cl. 3.

² 9 Wheat. 1, 6 L. Ed. 23 (1824).

of New York State to grant an exclusive navigation privilege between New York and New Jersey, and so exclude competitive navigation under a federal coasting license. Chief Justice Marshall, for the court, held that the power to regulate interstate commerce was vested in Congress by the Constitution, and that state provisions must give way before the superior power exerted in the federal act. However, he specifically refused to rule on the question as to whether the power to regulate interstate commerce is by the states "surrendered by the mere grant to Congress, or is retained until Congress has exercised the power." He said further, "We may dismiss that inquiry because it [the regulatory power] has been exercised, and the regulations which Congress deemed proper to make are now in full operation." It is well to bear this part of Marshall's opinion in mind whenever *Gibbons v. Ogden* is cited, as it sometimes is, for the proposition that the power of Congress to regulate interstate commerce is plenary and exclusive. The case does not lay down any such doctrine.

In another case,¹ again decided by Marshall, the court further elaborated its opinion. The State of Delaware had authorized the damming up of a navigable stream for the purpose of draining a swamp and thereby improving the health of the community. The constitutionality of such an action was attacked under the commerce clause, since there could be no question that the dam entirely prohibited all interstate commerce by means of the stream. In upholding the right of Delaware to authorize the construction of the dam, Marshall relied upon his statement in *Gibbons v. Ogden* that "the same measures, or measures scarcely distinguishable from each other, may flow from distinct powers." In other words, the action of the State of Delaware was a valid police power measure, as the power to take such action had been reserved to the states by the Constitution. In the absence of federal regulation of the same subject matter under the commerce clause, there was nothing to prohibit a state from protecting the health of its inhabitants, even though by so doing it seriously affected a navigable river. In other words, states may exercise their police power to the extent of seriously

¹ *Willson v. Blackbird Creek Marsh Co.*, 2 Pet. 245, 7 L. Ed. 412 (1829).

interfering with interstate commerce so long as Congress remains silent.

The next case to elaborate the commerce clause, and perhaps one of the most important decisions in the long history of interstate commerce, was *Cooley v. Board of Port Wardens*.¹ A Pennsylvania statute required all vessels to receive pilots for entering or leaving the port of Philadelphia, and those which did not were required to pay a certain fee in lieu thereof. An act of Congress in force at the time declared that all pilots in bays, inlets, rivers and harbors of the United States should be regulated in conformity with the laws of the states in which such pilots might be. It was vigorously contended that the Pennsylvania statute was a regulation of interstate commerce and a usurpation of a power exclusively confided to Congress by the Constitution. But the court, speaking through Justice Curtiss, denied that there was any usurpation, and in arriving at its conclusion made a distinction which has had a most profound effect upon subsequent judicial interpretation of the commerce clause. In upholding the Philadelphia statute the court said:

Either absolutely to affirm or deny that the nature of this power requires exclusive legislation by Congress is to lose sight of the nature of the subjects of the power, and to assert concerning all of them what is really applicable but to a part. Whatever subjects of this power are in their nature national, or admit only of one uniform system, or plan of regulation, may justly be said to require exclusive legislation by Congress. That this cannot be affirmed for laws for the regulation of pilots and pilotage is plain. The act of 1789 contains a *clear and authoritative declaration by the first Congress that the nature of this subject is such that until Congress should find it necessary to exert its power, it should be left to the legislation of the states*; that it is local and not national; that it is likely to be best provided for, not by one system, or plan of regulation, but by as many as the legislatures of the several states should deem applicable to the local peculiarities of the ports within their limits.²

The principle thus enunciated divides the subjects of interstate commerce into two classes, namely, those national in character which require "exclusive legislation by Congress", and those by their nature local, permitting of a diversity of

¹ 12 How. 299 (1851).

² Italics ours.

regulation. This latter class is subject to the power of the states, certainly in the absence of Congressional action. We are concerned here with the first class, for wholesale power transmission was placed by the Attleboro case¹ in the category of subjects national in character. Retail transmission, falling in the class denominated local,² remains subject to the jurisdiction of the states without any positive action by Congress.

What was really held in *Cooley v. Board*? Certainly that matters pertaining to pilots were local in nature and could be regulated by the states. But the question which is important here is the determination of the *criterion* by which the court adjudged them to be local. Was it because the Supreme Court deemed such matters inherently local, or because Congress had made a "clear and authoritative declaration" to that effect by the passage of the act of 1789? Stating the question another way, did the court hold that subjects of interstate commerce are exclusively within the jurisdiction of Congress by force of the Constitution itself, or did it hold that Congress might be the arbiter, and decide the question by its own authority? *Cooley v. Board* gives no definite answer to such a question, and the language of Justice Curtiss contains intimations which can be interpreted either way. In the excerpt from his opinion quoted above he appears to attach much significance to the "clear and authoritative" declaration of Congress to the effect that pilotage was a local matter. But he controverts this view when he says:

If Congress were now to pass a law adopting the existing state laws enacted without authority, it would seem to us to be a new and questionable mode of legislation. If the grant of commercial power in the Constitution has deprived the states of all power to legislate for the regulation of pilots, if their laws on this subject are mere usurpations upon the exclusive power of the general government, it may be doubted whether Congress could, with propriety, recognize them as laws, and adopt them as its own acts. . . .

From this it would seem that the court viewed the question of whether subjects of interstate commerce are "national" or "local" in nature as one determined solely by the Constitu-

¹ Cf. *supra*, p. 138, note 1.

² *Pennsylvania Gas Co. v. Public Service Comm. of N. Y.*, *supra*, p. 139.

tion, interpreted, of course, by the court. This of itself would exclude any power on the part of Congress to determine the question.

However, in considering the case of *Cooley v. Board* we must bear in mind the following: (1) that the Supreme Court did not definitely commit itself on the question as to whether Congress *could* determine whether a subject of interstate commerce is or is not national or local; (2) that the regulation which the court had before it was one upon which Congress had spoken, and that this spoken will was not overturned by the court; (3) that the court set at rest the contention, based upon a misinterpretation of *Gibbons v. Ogden*, that the Constitution denied to the states *all* power over the subjects of interstate commerce.

Naturally the question as to the power of the states over subjects "national" in scope arose when Congress itself had attempted no positive regulation, and therefore had, judicially speaking, remained "silent". In both *Gibbons v. Ogden* and *Cooley v. Board* Congress had expressed its views as to the nature of the subjects regulated. But in cases where there has been no federal legislation to guide the court the question is more difficult. And it is in the cases of this nature that we are given rather definite clues as to the Supreme Court's position.

Now, as we have said, if the states are, by the mere positive force of the commerce clause, excluded from exercising any regulatory authority over interstate commerce "national" in scope and requiring uniform regulation, the action which Congress takes is of no significance. The fact that it remains "silent" obviously should not affect the question. But the court in such cases seems to draw a most extraordinary inference from this "silence" on the part of Congress, namely, "that where the power of Congress to regulate is exclusive [subjects national in character] the failure of Congress to make express regulations indicates its will that the subject shall be left free from any restrictions or impositions, and any regulation of the subject by the states, except in matters of local concern only, as hereafter mentioned, is repugnant to such freedom."¹ This doctrine seems first to have been

¹ *Robbins v. Shelby County Taxing District*, 120 U. S. 489 (1887).

expressed by Justice Field in *Welton v. Missouri*.¹ There, in holding invalid a Missouri tax on vendors of foreign-made goods, he observed in part: "Its [Congress's] inaction on this subject . . . is equivalent to a declaration that the interstate commerce shall be free and untrammelled." Such a view has been reiterated and elaborated in many subsequent cases.²

This evident significance attached to the "silence" of Congress is weighty evidence that the Supreme Court takes the "will" of Congress as the criterion for determining the validity of state regulation. It is certainly incompatible with the view that the Constitution itself restrains the states from regulating subjects which the court thinks require uniformity of regulation and are therefore "national" in character. For if the Constitution does so operate, why talk about the "silence" of Congress at all? And surely if the court professes to be bound by the "will" of Congress implied from its silence, it cannot logically fail to follow that same "will" when expressed by positive legislation, even though such legislation might violate what the court itself believed to be sound policy. But let us pass on to cases which show what the court has done when Congress did express its "will" in the matter.

During the latter part of the nineteenth century there were several states which had adopted local prohibition, and these states were faced with the problem of protecting themselves from the influx of intoxicating liquor through the channels of interstate commerce. Iowa sought to stem the tide by prohibiting carriers from bringing intoxicating liquors into the state for consignees not duly authorized to receive the same. This act received a judicial clubbing in the case of *Bowman v. Chicago N. W. Ry. Co.*³ The court admitted that the statute had been passed under the police power of the state, but it held such matters as the interstate transportation of

¹ 91 U. S. 275

² *Hall v. DeCuir*, 95 U. S. 484 (1877); *County of Mobile v. Kimball*, 102 U. S. 691 (1881); *Escanaba Co. v. Chicago*, 107 U. S. 678 (1882); *Covington Bridge Co. v. Kentucky*, 154 U. S. 204 (1894); *Missouri v. Kansas Natural Gas Co.*, 265 U. S. 298 (1924); *West v. Kansas Natural Gas Co.*, 221 U. S. 229 (1911). See also an article by Biklè, "The Silence of Congress," 41 *Harv. L. Rev.* 200 (1928).

³ 125 U. S. 465 (1888).

liquor to be national in character and to demand uniformity of regulation. The act was therefore declared to be of no effect.

Following close upon the Bowman case came *Leisy v. Hardin*,¹ which held the officials of Iowa to be powerless to seize shipments of intoxicating liquors from other states while still in the original packages.² The principle of the Bowman case was reiterated, namely, that interstate commerce in liquor was national in character, demanding uniformity of regulation, and therefore beyond the jurisdiction of the states. Furthermore, the court held sale in the original package to be essentially a part of interstate commerce.

But *Leisy v. Hardin* is more important for another reason. Chief Justice Fuller, writing for the court, felt called upon to go fully into the nature of the power to regulate commerce as distributed between the nation and the states. The Iowa statute, he reasoned, was passed in the exercise of the police power, but it was inapplicable because of the will of Congress implied from its silence. And he continued: "Yet a subject matter which has been confided exclusively to Congress by the Constitution is not within the jurisdiction of the police power of the state, *unless placed there by congressional action.*"³

He could hardly have made the court's position plainer. Subjects of a national character are beyond the scope of state police power unless placed therein by congressional action! The prohibition forces were not slow in taking the suggestion of the court, as will later be seen.

So far as the actual decision in *Leisy v. Hardin* went, there can be no doubt that the court considered interstate shipments of liquor as requiring uniformity of regulation, and not susceptible to regulatory authority of the states. In this respect it is similar to the decision in the Attleboro case,⁴ which announced the same rule in reference to wholesale interstate transmission and distribution of power.

In 1890 Congress passed the Wilson Act,⁵ which had as its

¹ 135 U. S. 100 (1890).

² The "original package" doctrine was first enunciated in *Brown v. Maryland*, 12 Wheat. 419 (1827).

³ Italics ours.

⁴ Cf. *supra*, p. 138.

⁵ 26 Stat. at L. 313 (1890).

object the abrogation of the rule announced in the *Leisy* case. It was based squarely upon the theory of Congressional permission. It provided:

That all fermented, distilled, or other intoxicating liquors or liquids transported into any state or territory and remaining therein for use, consumption, sale or storage therein, shall upon arrival in such state or territory, be subject to the operation and effect of the laws of such state or territory enacted in the exercise of its police powers, to the same extent and in the same manner as though such liquors or liquids had been produced in such state or territory, and shall not be exempt therefrom by reason of being introduced therein in original packages or otherwise.

The statute simply operated to permit the states to get at interstate shipments of liquor one step earlier than they otherwise could under the *Leisy* case.

The constitutionality of the Wilson Act was put squarely before the Supreme Court in the case of *In re Rahrer*.¹ The main difficulty which had to be overcome was the apparent delegation of authority to the states to regulate interstate commerce which the court had held to be national in character. But Chief Justice Fuller, again writing for the court, upheld the act by the following reasoning: Without question Iowa might seize shipments of intoxicating liquor in so far as such action did not conflict with the commerce power of Congress under the Constitution. The decision in *Leisy v. Hardin*² did not really nullify the law involved there, but merely rendered it inoperative as to property not within the jurisdiction of the state. But Congress, as a part of its power to regulate interstate commerce, has the right to declare when imported property falls within the jurisdiction of a state. When it does so, state jurisdiction attaches "not by virtue of the law of Congress, but because the effect of the latter was to place the property where jurisdiction could attach." The state thus had no more power than it originally had. The Wilson Act merely removed the bar to the exercise of a reserved power. This bar was not imposed by the Constitution, but by the "implied exercise of a power exclusively confided to the national government." The logical result of the doctrine of

¹ 140 U. S. 545 (1891).

² Cf. *supra*, p. 148, note 1.

implying the "will" of Congress, and making it the basis of a rule is seen from the following words of the Chief Justice:

The differences of opinion which have existed in this tribunal in many leading cases upon this subject have arisen, not from a denial of the power of Congress, when exercised, but upon the question whether the inaction of Congress was in itself equivalent to the affirmative interposition of a bar to the operation of an undisputed power possessed by the states.

*We recall no decision giving color to the idea that when Congress acted its action would be less potent than when it kept silent.*¹

Due to the fact that the decision of the Supreme Court in *Rhodes v. Iowa*² construed the Wilson Act in such a way as to deprive it of much of its practical effectiveness, the dry forces were driven to seek for other federal legislation, and the fruition of their efforts was the so-called Webb-Kenyon Act³ passed over a presidential veto in 1913. The main provisions of this act were as follows:

An Act divesting intoxicating liquors of their interstate character in certain cases.

. . . That the shipment or transportation, in any manner or by any means whatsoever, of any spirituous, vinous, malted, fermented, or other intoxicating liquor of any kind, from one State, Territory, or District of the United States, . . . into any other State, Territory, or District of the United States . . . which said . . . liquor is intended, by any person interested therein, to be received, possessed, sold, or in any manner used, either in the original package or otherwise, in violation of any law of such State, Territory, or District of the United States . . . is hereby prohibited.

The wording of this act, as can be readily seen, differs from that of the Wilson Law. Except for the title and for the fact that no penalties are provided for breach, the Webb-Kenyon Law would seem to be mere Congressional prohibition conditioned upon state laws.⁴

¹ Italics ours.

² 170 U. S. 412 (1898). This case construed the word "arrival" to mean arrival to the consignee.

³ 37 Stat. at L. 699-700 (1913).

⁴ An article by N. T. Dowling and F. M. Hubbard entitled "Divesting an Article of Its Interstate Character", 5 Minn. L. Rev. 100, 253, gives a clear and critical account of the debates in Congress, and the probable intent of that body.

The constitutional test came in the case of *Clark Distilling Co. v. Western Maryland Ry. Company*.¹ The facts of the case, which are not important here, involved directly the federal legislation, but the court went on and also discussed the constitutionality of the state prohibition law. The dictum in this respect was upheld later in *Seaboard Air Line Ry. v. North Carolina*,² so we may regard it as authoritative.

Although the reasoning of the opinion in the Clark case is rather confused, it is sufficiently plain to leave no doubt as to the attitude of the court. What may be called the primary reasoning is very simple. It is merely this: The Lottery cases³ and *Hoke v. United States*⁴ show, by analogy, that Congress, under the commerce clause, has the power to prohibit the interstate transportation of liquor altogether. The Webb-Kenyon Act does less than this, for it only prohibits such traffic in certain instances. Thus, upon the principle that the whole must contain its parts, the act should be sustained as a valid regulation of commerce. And upon the principle of *In re Rahrer*⁵ it would operate to place liquor within state jurisdiction as soon as it crossed the border.

The chief difficulty with the case, and with any case involving Congressional permission, is the question of the delegation of power by Congress to the states to regulate interstate commerce. Can it be said that Congress, in permitting the states to regulate interstate shipments of liquor, or, as in our problem, wholesale interstate transmission of power, is actually delegating its authority in contravention of the Constitution? Chief Justice White answered the whole question by the following reasoning:

The argument upon the delegation to the states rests upon a mere misconception. It is true the regulation which the Webb-Kenyon Act contains permits state prohibitions to apply to movements of liquor from one state to another, but the will which causes the prohibitions to be applicable is that of Congress, since the applications of state prohibitions would cease the instant the act of Congress ceased to apply.

¹ 242 U. S. 311 (1917).

² 245 U. S. 298 (1917).

³ 188 U. S. 321 (1903).

⁴ 227 U. S. 308 (1913).

⁵ Cf. *supra*, p. 149, note 1.

However, it is submitted that the Chief Justice himself failed to consider fully the problem dealt with in the passage quoted. The problem of the delegation of power in such legislation really involves two distinct questions. The first, and the one he evidently had in mind, is the question as to whether Congress, by the passage of permissive legislation, is actually regulating commerce, or is merely passing the buck to the states, so to speak. As to this point, the argument of the Chief Justice seems to apply. It has been suggested,¹ and it seems reasonable, that the operation of such an act is no more a delegation of power than the acts of Congress which permit an administrative authority to determine the conditions on which the law applies, for in permissive legislation Congress is only substituting state legislatures for administrative bodies, the difference being one of degree only. And certainly the practice of permitting administrative agencies to determine the conditions on which a law applies is not unconstitutional as a delegation of power.²

The second question, which is separate and distinct from the first, is as to whether the states themselves, in passing regulations in accord with the act of Congress, are in effect exercising delegated authority. Although this point was not clearly analyzed by Chief Justice White in the *Clark Distilling Company* case, he really disposed of it when he grounded his decision on *In re Rahrer*,³ for he refers to the Webb-Kenyon Act as being "but a larger degree of the exertion of the identical power which was brought into play in the other [Wilson Act]." The theory adopted by the court in the *Rahrer* case in reference to the Wilson Act as applied to state legislation in accord with the Webb-Kenyon Act runs something like this: The prohibition of all transportation of liquor in the state is valid under state police power. But this power must not be exerted so as to interfere with interstate commerce which Congress either expressly or impliedly, by its silence, desires to remain free. But Congress, in exercising its commerce power, may place interstate commerce in liquor

¹ Powell, "The Validity of State Legislation Under the Webb-Kenyon Act", 2 *Southern Law Quarterly* 112, 125 (1917).

² *Field v. Clark*, 134 U. S. 649 (1891).

³ Cf. *supra*, p. 149, note 1.

where state police laws can apply. No power is delegated; for the state, in prohibiting the transportation of liquor, is exercising a reserved power under the Constitution, namely, its police power.

Really, there is nothing startlingly novel about the theory of Congressional permission, since an examination of federal legislation shows that it has long been in vogue in many fields.

The earliest instance we have of such a theory is the enactment of quarantine and health laws by Congress in 1790,¹ to the effect that all federal revenue officers should observe state quarantine laws respecting vessels from foreign ports or ports of other states, and aid in their execution. This was simply a recognition on the part of Congress of the power of the states to protect the health of their citizens under the police power, at the expense of interstate commerce. The acts were upheld *obiter* by Chief Justice Marshall in *Gibbons v. Ogden*.²

Again, in 1803, Congress passed an act³ prohibiting the importation of slaves into states having laws against it. This was held constitutionally valid in *The Brig Wilson*.⁴ Although the opinion was more or less directly founded upon the provisions of the Constitution in regard to the slave traffic, it is nevertheless in accord with the general principles governing the type of legislation with which we are dealing.

For some time an act has been in force which permits any state, territory, district, city or town to prohibit the importation of nitroglycerine.⁵ The theory probably rests upon the proposition that states can prohibit the importation of deleterious matter. However, in this particular instance Congress did not regard the chemical as so deleterious as to call for absolute prohibition, but was content to make certain federal safety regulations. The validity of this Congressional "permission" has never been questioned.

Modeled precisely like the Wilson Act was the law⁶ which Congress passed "divesting" oleomargarine and similar sub-

¹ 1 Stat. at L. 474, 619.

² Cf. *supra*, pp. 142-43.

³ The object of the statute was to make state laws effective.

⁴ 1 Brockenborough 423, 437 (1820).

⁵ See R. S. Sec. 4280.

⁶ 32 Stat. at L. 193 (1902).

stances of their interstate character. Its validity was upheld without question by the Circuit Court of Appeals in *United States v. Green*.¹ The theory of the legislation was evidently to permit the states to protect their citizens from fraud, an admittedly valid object under the state police power. It is hard to realize just why such legislation was necessary, since the Supreme Court had already held that a state could prohibit the sale of colored oleomargarine in the original package, even in the absence of federal legislation.² At any rate, the act was based squarely upon the theory of permission, and was upheld entirely upon the authority of *In re Rahrer*.³

Another fairly analogous piece of legislation is found in the so-called Lacey Act,⁴ which prohibits any person from delivering for shipment or any common carrier from shipping game killed in violation of state laws. The act specifically exempts game lawfully killed, and the state police power is thus effectuated. The constitutionality of the law was upheld in *Rupert v. United States*.⁵

The two latest examples of Congressional permission are the Plant and Quarantine Act⁶ and the Hawes-Cooper Act.⁷ The former permits states to prohibit the importation of diseased plants from other states until the Secretary of Agriculture has determined upon a quarantine in respect to them. If, after the declaration of a quarantine, the plants are shipped regardless, they are declared to be divested of their interstate character, and the police laws of the states into which they are shipped are permitted to apply. The Hawes-Cooper Act, passed in 1929, provides for the divestment of their interstate character of convict-made goods, so as to permit the states to prohibit their sale. Neither of these two recent statutes has come up for judicial review as yet.

Most important, however, in this connection is the principle

¹ 137 Fed. 179 (1905).

² *Plumley v. Massachusetts*, 155 U. S. 461 (1894).

³ Cf. *supra*, p. 149, note 1.

⁴ 35 Stat. at L. 1137 (1909).

⁵ 181 Fed. 87 (1910).

⁶ 44 Stat. at L. 250 (1926).

⁷ 45 Stat. at L. 1084 (1929).

of Congressional permission found in the present Federal Water Power Act.¹ The act provides for the licensing of power projects on navigable streams, and stipulates numerous conditions which must be complied with before the commission² is authorized to issue such a license. It is in Section 20 of the act, dealing with rates and services, that the principle of "permission" is found. The section reads in part:

That when said power or any part thereof shall enter into interstate or foreign commerce, the rates charged and the service rendered by any such licensee, or by any subsidiary corporation . . . shall be reasonable, nondiscriminatory, and just to the customer, and all unreasonable, discriminatory, and unjust rates or services are hereby prohibited and declared to be unlawful, *and whenever any of the States directly concerned has not provided a commission or other authority to enforce the requirements of this section within such state . . . jurisdiction is hereby conferred upon the Commission [Federal], upon complaint of any person aggrieved, upon the request of any State concerned, or upon its own initiative, to enforce the provisions of this section. . . .*³

In other words, Congress expressly permits the states to regulate the rates and services of its own licensees in respect of the interstate commerce within their own boundaries, and only provides for federal regulation in the absence of state control. This provision, as far as we have been able to determine, has never been questioned.⁴

IV

Analysis of the Rahrer⁵ and Clark Distilling Company⁶ cases leaves no doubt that the Supreme Court recognizes the doctrine of Congressional permission and state laws passed in accord therewith as valid from a constitutional standpoint. In addition, the fact that the theory of permission to the states to regulate subjects of interstate commerce is found in Con-

¹ 41 Stat. at L. 1063 (1920).

² The Federal Power Commission, which is the administrative body created by the Water Power Act. It is this body which has recently been criticized by the Senate Interstate Commerce Committee.

³ Italics ours.

⁴ A somewhat similar plan of operation is incorporated in the Couzens Bill, as shown by the quotation *supra*, p. 141, note 2.

⁵ *Supra*, p. 149, note 1.

⁶ *Supra*, p. 151, note 1.

gressional legislation dating practically from the ratification of the Constitution to the present day, and has never been refuted by the court, is ample evidence that there is nothing revolutionary in such a doctrine. And the instances of its use indicate that in the past it has not simply been applied to intoxicating liquor.

Therefore the conclusion seems warranted that it would be proper for Congress, under the commerce clause, to pass legislation extending the doctrine to embrace interstate transmission of power, and thereby permit the states to regulate, under their police power, that part of the transmission which has been held, in the absence of Congressional action, to be beyond their jurisdiction. The constitutional status of such legislation would seem to be this: The states have no power to regulate interstate commerce national in character. But they do possess their reserved police power, which has never been taken from them by the Constitution. However, the commerce power of Congress is superior to this police power of the states, and in the absence of Congressional action the Supreme Court holds that it is the "will" of Congress that interstate commerce national in character remain free from any state interference. But if this implied restraint by the "will" of Congress is abrogated by an express permission, there is nothing to prevent state police power from applying, since the only bar has been removed.¹ This seems to be the only way to interpret the view of the Supreme Court as embodied in the cases. That such a rationale is determinative of our problem seems plain.²

¹ See Bicklè, "The Silence of Congress", 41 *Harv. L. Rev.* 200 (1928).

² It has been suggested by Professor Thomas Reed Powell in "Validity of State Legislation under the Webb-Kenyon Law", 2 *Southern Law Quarterly*, 112-139, that the due process clause of the Fifth Amendment might be invoked as a protection against unwarranted diversification of interstate commerce regulation by Congress through permissive regulation. Our study, however, does not include this phase of the problem.

DISCUSSION: IMMEDIATE PROBLEMS IN PUBLIC CONTROL¹

THE CHAIRMAN:² The general topic is now open for discussion under the five-minute rule.

DR. EDWARD W. BEMIS (consulting engineer on public utilities and former member of Advisory Board of Interstate Commerce Commission): I will not enter into any considerable discussion but will merely suggest one or two points very briefly.

One is the great encouragement that comes from having such discussion as this. It is quite interesting to note how prominent a part Columbia University is playing in this conference. If all our universities would perform similar services it would be a grand thing, I believe. And there are other institutions that are beginning to do so, I discover.

Another point I should like to make is that there are methods of regulation, not touched on here, which perhaps should be considered. For instance, although I am not advocating it, I might mention a method employed particularly in Ohio, where cities under home rule charters have the right to assume a large degree of regulation and get out from under the state commission if they so desire. Such is the situation in Cincinnati, Cleveland and several other of the important cities of the state. In Cincinnati the other day I heard expressions of great satisfaction with the results.

A third point worth considering is the human character of our regulating bodies and the extreme importance of bearing that in mind in the selection of the members of our commissions and courts. Infallible interpretation of what is constitutional and a matter of public policy is not as clear sailing as some have seemed to believe; there is a great opportunity for the human equation, for the points of view of the persons selected to administer these commission powers and to interpret constitutional rights. There is greater significance than has been realized in the recent contest over the confirmation of the appointment of Justice Hughes to the Supreme

¹ An abstract of the informal discussion which followed the addresses by Messrs. Seligman, Bonbright, Insull, Le Boeuf, Hale, Goldberg and Dowling at the afternoon session of the Semi-Annual Meeting of the Academy of Political Science, April 11, 1930.

² Professor Edwin R. A. Seligman.

Court. The extent to which the members of the House of Representatives flopped over to the Senate to listen to that discussion, crowding the space to the doors, indicated the growing interest in the choice of the men called on to interpret the Constitution.

This idea of the importance of the personnel of our courts and commissions is not yet well developed in the country at large, but it is a growing thought and is going to have an immense influence in the future. The development of education along these lines will direct more attention to the point of view of our judges, for it is a fact that while they often say they find the law to be, the fact is that they make the law to be, and they make it by their views. There is not such a clear rule of determination that one point of view on reproduction or another point of view on actual cost or investment can be regarded as infallibly correct. I have no doubt that the minority of the Supreme Court are just as competent and honest as the majority, and yet they will differ radically on the interpretation of such matters. There was a change of four members of the Supreme Court in nineteen months under President Harding, owing to vacancies—something that never has occurred before in the history of this country, and which is undoubtedly responsible for some of the changes that have occurred in our constitutional decisions.

MR. ERNEST GRUENING (Editor, *The Portland Evening News*, Portland, Maine): One question that I should like to raise grows out of a statement of Mr. Martin Insull's, which was, as I understood it, to the effect that there was no connection between the issue of the holding company securities and the rates of the operating companies. It seems to me that this touches a very vital point, and I personally would like to hear a little elaboration of it by him or by anyone else who cares to discuss it.

The usual structure of the operating company and then of the holding companies is such that the operating company floats securities consisting of bonds and preferred stock, paying six or seven per cent on the preferred stock and a lower rate on the bonds, say five per cent. The income of the operating company is, of course, entirely from what the consumer pays. After the interest and dividends have been paid on the bonds and preferred stock, whatever is left goes to the common stock, and that common stock is owned by the first holding company.

This holding company in turn floats bonds and preferred stock, but virtually its only source of income is this same revenue from the original consumer, the operating company consumer. It is true, of course, that the holding company may have other investments; it

may speculate; but essentially its sole revenue comes from the bottom. Then on top of this holding company, you have another holding company, which derives its sole revenue through the control of the common stock of the first holding company. And so on up.

In Maine, for instance, we have a superimposed tier of five or six companies. Now, is it not obvious that the rate at the bottom has to be sufficiently high to pay returns to the investors in all these various companies, and that if the rate at the bottom is cut, the return first to the top company and successively to each lower company will be reduced? If that is the case, arguing inversely, why has not the existence of these various superimposed holding companies a definite bearing on the rate paid by the consumer?

MR. MARTIN J. INSULL (President, The Middle West Utilities Company): Please state the question again.

MR. GRUENING: I was referring to your statement that the issuing of securities by the holding companies had no bearing on the rate of the operating company, and I sought to develop the point that essentially the only income of these various superimposed holding companies was the money paid by the consumer at the bottom to the operating company, and that consequently if that rate were drastically reduced, the income of these various holding companies would dry up, beginning from the top, and that consequently to support these holding companies, to make them profitable, to allow their securities to be marketed, the rate at the bottom would have to be higher than it would be if there were no such structure of holding companies.

MR. INSULL: I think that question has been answered all the afternoon. The whole discussion this afternoon has been on the rate base. Rates are not based on security issues of any kind, whether of operating companies or holding companies, or top holding companies or middle holding companies. Rates are based on some value of the property used and useful for the public service. It seems to me that what we have been trying to get at this afternoon are the different views with regard to what that value should be, but in none of those discussions have securities taken any place whatever. Does that answer your question?

MR. GRUENING: No, it does not. Has the ordinary holding company any considerable, any material, source of revenue but its equity in the common stock of the producing company, the operating company?

MR. INSULL: That depends on holding companies.

MR. GRUENING: Well, generally speaking.

MR. INSULL: As a general proposition, no, but that has nothing to do with the rate of the operating company.

MR. GRUENING: Why not? If they derive their revenue from this one source, and that revenue is reduced, which would mean of course a lowering of rate to the consumer, why doesn't the holding company pyramid topple over and disappear?

MR. INSULL: Let me put it another way. If you, instead of a holding company, hold some of the common stock of an operating company, do you have any influence on the rate? If a thousand people own the common stock in a holding company, do they have any influence on the rate? If one person owns it, does he have any influence on the rate?

MR. GRUENING: Certainly. They would not hold it if there were not some profit in it, any more than the holding companies would hold it if there were no profit in it. If there were no profit in it, the holding company would not exist, but as long as you keep your rates high, your holding company is going to exist. Your holding company is therefore directly the cause of a higher rate.

MR. INSULL: Not at all. I would like a commissioner to answer the question. I evidently cannot answer it.

THE CHAIRMAN: In other words, what Mr. Insull means, and we leave it to you to judge whether it is correct, is that the gentleman is putting the cart before the horse; that the profits of the holding company depend upon the rate, but that rate does not depend upon the existence or the profits of the holding company. That is your point, is it not?

PROFESSOR ROBERT L. HALE (Assistant Professor of Legal Economics, Columbia University): I think there is a slight misunderstanding between the two gentlemen which perhaps could be cleared up. Mr. Insull's point, as I understand it, seems to me an entirely sound one—as far as it goes. As I take it (you will correct me if I am wrong), the rates are fixed on the fair value of the operating company's property, whatever that term may mean; but whatever it means, it is not influenced by the amount of securities of the holding company, and what the holding company can get is a result

of the rates allowed on the fair value of the operating company's property. The case is analogous to that of the private investor in that the rates are not raised because you want to invest, but you invest because the rates are high.

I do not think that is a complete answer, and for this reason: the fair value, so-called, of the operating company's property is not actually based on market value. If it were, the commissions never would be able to reduce rates, because they would clearly be reasoning in a circle. What they do is to compound a kind of synthetic value. They find the figures of reproduction cost and the figures of depreciation and the figures of original cost, plus subsequent investments, and a few other items.

In *Smyth v. Ames*, they were told to take into account the amount and market value of the stock and bonds. Usually, as Mr. Insull says, they do not do that in their decisions. But they take all these other figures, and then they say, on the whole, we think the fair value is so many dollars; and you cannot find out how they reached that figure.

I was listening to some of the testimony given before the Knight Commission when Mr. Prendergast was on the stand. In two cases he and Commissioner Van Namee dissented from the majority of the commission on valuation. Figures had been found for reproduction cost which were relatively high, and for original cost which were relatively low, and the majority of the commission found the fair value to be something rather near original cost, and not so near reproduction cost. Commissioner Prendergast and Commissioner Van Namee dissented, thinking that the figure ought to be nearer to reproduction cost.

My recollection of this hearing was that Mr. Bonbright questioned Mr. Prendergast as to just why he thought the value in this case was nearer reproduction cost. Mr. Prendergast had said he did not understand value to mean market value but that amount which one finds after giving due weight to all these factors. That leaves a pretty good play for what you consider due weight. When Mr. Bonbright asked him to explain why he and Mr. Van Namee thought the value as an objective fact was something nearer reproduction cost whereas the other commissioners thought it was something nearer actual cost, Mr. Prendergast answered, "Why, it is for the same reason that one man prefers beefsteak and one prefers oatmeal for breakfast." Thus the finding of the fair value depends a good deal on the appetites of the commissioners. If one commissioner, however, happens to prefer beefsteak and puts the value up near reproduction cost, it may conceivably be that he fears

that with the capital structure such as it is in a particular case, the rates might not otherwise be high enough to pay interest on the securities outstanding. In other words, he may be influenced by the amount of security issues. We cannot tell from the opinions. Mr. Bonbright long ago pointed out this very point that I am making, but in his silence I thought I would interpret it.

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PART III
THE FUTURE OF POWER SUPPLY
AND PUBLIC CONTROL

INTRODUCTORY REMARKS¹

WILLIAM L. RANSOM

Acting President of the Academy of Political Science

WE come now to the addresses which will conclude a day of brilliant discussion. To you who have not been able to attend the sessions of the morning and afternoon, I may say that we have listened to some very informing addresses and papers, which may advance to a marked degree the public understanding of a vital subject.

I cannot say that agreement was reached, or any consensus of opinion, nor is unanimity likely here tonight; but I do believe that a reasoned, forward-looking discussion has taken place, and will be continued tonight—a discussion in which sincerely differing views have been expressed with great ability and clarity.

We miss very keenly from this dinner and from the post which I temporarily occupy tonight our beloved Professor Samuel McCune Lindsay, who has served for nearly twenty years as President of the Academy and has been an unselfish, tireless worker in its behalf. He is now in the Orient, enjoying a brief respite from University duties, and in your behalf we shall send him greetings and all good wishes for a pleasant journey and return to his useful work in many good causes.

This semi-annual meeting and this dinner are a part of our celebration, if I may use that word, of the fiftieth year of the work and leadership of the Academy of Political Science. Founded under the guidance of Professor Burgess in 1880, the Academy has for half a century rendered a useful public service in the study and public discussion of political, social and economic questions. It has on many occasions made real contributions to an informed public opinion.

In a book published last year by Lord Hewart of Bury,

¹ Introductory remarks as presiding officer at the dinner session of the Semi-Annual Meeting of the Academy of Political Science, April 11, 1930.

under the title, *The New Despotism*, the Lord Chief Justice of England discusses what he describes as the growth of government by departments, government by orders, rules and regulations, promulgated by departments or commissions which seek to set themselves above Parliament and the courts and subject to minute control the conduct of individuals and the management of business. In comment upon this tendency, he sets forth this striking paragraph :

Much toil and not a little blood have been spent in bringing slowly into being a polity wherein the people make their laws, and independent judges administer them. If that edifice is to be overthrown, let the overthrow be accomplished openly. Never let it be said that liberty and justice, having with difficulty been won, were suffered to be abstracted or impaired in a fit of absence of mind.

The Academy of Political Science has for years done its part in overcoming any possibility that public questions in its field might be disposed of in any "fit of absence of mind." One of the most important but controversial questions in the field of public law and social science, one which touches now the lives of our people at every point and in almost every home, was selected by the Trustees as timely for today's meeting; and we have had a stimulating and thoroughly representative exposition of opposing points of view.

I shall not undertake discussion of this subject on my own part, but shall proceed to present to you those whom you have come to hear.

IS THE INTEREST OF THE PUBLIC INCONSISTENT WITH THE INTEREST OF THE UTILITIES?

WILLIAM J. DONOVAN

Counsel of the New York State Commission on Revision of the
Public Service Commissions Law

WE cannot understand the problems involved in the control of our public utilities unless we consider the philosophy underlying the control of our industrial life. The economic theories dominant at the beginning of the nineteenth century were the principles of "free enterprise" and of "the competitive system".

The basic assumption of these theories was that the less the government has to do with business, the better. It was then believed that the interests of the public would be best cared for by maintaining individual enterprise in a highly competitive struggle. It was assumed that prices would be reasonable, and that exorbitant prices would be checked, because competitors would have to struggle in the market. In this way the incentive for profits, which, we must not forget, is the underlying incentive for all private enterprise, was supposed to be held in a proper balance. It was believed that laborers would be paid a fair wage for their work because employers would have to compete in the market for their services. Price would be determined in the competitive market and profits would depend upon efficiency. The particular company which could lower its costs of production to the lowest possible point made the highest profits, and the concern which lagged behind in initiative, in inventiveness and in efficiency paid the penalty for its backwardness. So ran the theory. But the true story is not so simple.

The history of the control of our industrial life during the last century is compelling evidence that we must make a frank reappraisal of our early economic ideas. Our great industries, especially, do not exist as ends in themselves. We are not interested in having steel and oil and electricity and

gas for the sake of having them. We are interested in these commodities because of the contribution they make to the satisfaction of human wants. In this view, our economic institutions and the managers, investors and workers are instrumentalities, useful agencies of the community to satisfy economic wants.

We speak of the ideal of an industry controlled solely by "free competition". This ideal of control has never been fully realized in practice. It has been compromised in a variety of ways. It has been compromised by the state in the enactment of a mass of regulatory legislation, particularly in the last fifty years. It has been compromised in the interests of the laborer in the enactment of safety codes, factory laws, workmen's compensation laws, employer's liability laws, laws limiting the hours of labor, fixing the manner in which the workers' wages shall be paid and laws relating to trade unions.

From another point of view, our industrial institutions have not developed according to the preconceived pattern of the competitive ideal. We have our anti-trust laws and our laws against unfair methods of competition because of our fear of oppressive monopolies and of practices detrimental to the public interest. These laws again are compromises with the ideal of the free operation of the principle of competition.

We have customarily divided business into two categories—the one private and to be controlled by the operation of the principle of competition with the resultant compromise; the other to be controlled, not by the principle of competition, but by the power of the state. These categories of "publicness" and "privateness" are familiar.

The proposition that our great industrial institutions are instrumentalities of the community cuts across this preconceived category of "publicness" and "privateness". In this view there is little room for the formulation of general principles which are universally applicable to all economic enterprises. In fact, the principle of competition has been compromised so often, so freely, and in so many industries that we may well ask ourselves whether it provides anything more than one system of control, one of several standards for testing the serviceability of economic institutions. If we are to ask whether a given industry is fulfilling its

obligations to the public, we must have some standard, some test to apply. In this country we have many gigantic aggregations of capital which, by reason of their long history, their continuity of management, and the essential character of their service, may be said to have become institutionalized. I need only mention the great steel, oil, coal and electrical manufacturing corporations, not to mention the familiar class of public utilities. We have come to look upon them as constituting the fibre of our economic and social existence.

In another respect we must be prepared to revamp certain conventional economic theories. The regulation of our public utilities is generally justified on the assumption that they are "natural monopolies". This in turn means that without some form of regulation the public utilities would be left entirely free to charge what rates they chose, limited only by what the traffic would bear. In this way it is assumed that without some form of regulation the public utilities would inevitably exact monopolistic and extortionate rates to the manifest injury of the consumer. This theory, as I have indicated, assumes a condition of complete monopoly. Let us examine this proposition. The merchant of today in other lines of business has come to realize that the keenest competition which he encounters is not from his competitors engaged in the same line of business but from rivals offering to the public an infinite variety of substitute articles. This is a competition which Mr. Justice Holmes has aptly described as "the competition of conflicting human desires".

There are some economists today who assert that this competition exists in the public utility field just as much as in the field of general business. And in proof of their assertion they point to the potential if not actual competition of industrial plants able to provide power for their own use.

Every railroad executive experiences the keenest sort of competition, not only direct competition from other lines, but also competition from different means of transportation. He also experiences the indirect competition of the manufacturers or producers whose markets are in part determined by transportation charges. In the communications field the telegraph, telephone, mail, air-mail and radio all offer a variety of means for the transmission of messages in one form or another.

Under such conditions it is idle to assume that any one form of communication enjoys a monopoly. The result is that while these public utilities may be characterized as monopolistic, the development of our economic life has created a great variety of competing services and commodities, which tend to lessen the danger of abuses. Further, the wide distribution of stock has brought into the investor class a large number of consumers who are now for the first time appreciating the consistency of interest between themselves and the corporations in which they have invested their money.

Reference has been made to the general question of economic theory and of public policy because otherwise, in considering the regulation of public service corporations, we are apt to be led blindly into a shortsighted program based on the use of force and coercion, rather than a policy which is progressive because realistic.

Sight is frequently lost of the fundamental basis of all public utility regulation. In simple terms it is this: The state has hired the utility companies to assume the burden of doing a job which the state itself was unwilling or unable to perform. The state then, in the public interest, must be sure that no act on its part shall prevent the free flow of capital to these enterprises without which this essential task cannot be adequately performed. Any choice of method of regulation must recognize this necessary obligation. The selection of a particular method of control has, in the past, been based upon the theory that public utilities, although affected with a public interest, are essentially private enterprises, and that the duty of the state is to protect the consumer from exploitation by those engaged in conducting these enterprises. This involves the assumption that the interest of the state in so protecting the consumer is necessarily opposed to the interest of those who have invested their capital in such enterprises. It is, therefore, not surprising to find that the history of public utility regulation is too often that of a running conflict between the state and the utility companies with resultant loss to the consumer and the investor.

A true conception of property rights involves a recognition that these rights are essentially social institutions. They are not absolute values. Their nature changes with social and

economic conditions. For the utilities and the public it is essential to preserve a stable social organization under which their respective relationships can be worked out fairly and be reasonably acceptable to both.

The public character of the business conducted by the utilities and the public privileges under which they operate should serve to emphasize the fundamental identity of interest of the utilities and of the public in these enterprises even more than in the case of purely private business.

It has been said that, while the interest of the public and of the utilities may be identical to a certain point, when that point is reached there is a divergence of interest. It may be that, a different relative emphasis being placed upon particular aspects, the interests of the one may not be identical with the interests of the other; that the temporary pecuniary interests of both are in conflict. But it is difficult to believe that they are inconsistent and impossible of reconciliation. When we consider the various elements of the public interest and the real interest of the consumers and investors, it is hard to see how these interests are in conflict. The interest of the consumer is to have the best possible service with improved facilities at reasonable rates, low enough to permit of the general use of the service for all of the functions to which it is economically suited. It is important for the consumer that rates and net earnings shall be sufficient to attract continuously the vast amount of capital necessary for improving plants and extending service, and for the utilities to see that the invested capital shall be provided with a fair annual return and that new capital shall be attracted sufficiently to provide for steady growth of the industry. It is important for both interests that the utilities shall be so managed and regulated that their service will aid in the prosperity of industry and in the elevation of the standards of health and of comfortable living.

The striking example of apparent inconsistency is that of valuation. This problem is one of many encountered in the detail work of regulation. It was the subject of discussion by all of the experts called in the recent investigation by the legislative commission of this state and constitutes the most mooted question of that inquiry.

The Supreme Court has held that a public utility is entitled

to earn a reasonable return upon the fair value of the property which it is devoting to public service and that the fair value of the property must be determined as of the time the inquiry is made. In determining that value, the court has held that all relevant factors must be considered, including, among others, costs of reproduction new less depreciation, and original cost.

It is apparent that the application of this principle, at least to present-day conditions, has been difficult of administration, and has frequently resulted in injustice and hardship both to the consumer and to the utility. It has caused protracted litigation and has delayed final determination by the regulatory body from two to ten years, when that determination is no longer applicable and further litigation may well ensue.

Today many of those who claim to represent the interests of the public contend that the value of the property for rate-making purposes should be based solely upon a consideration of its original cost. However, this has not always been the case. When *Smyth v. Ames*¹ was decided in 1898, it was argued on behalf of the consumer that the reasonableness of rates to be charged by a public utility should be tested solely by a consideration of the cost of reproducing the property. At that time the general price level was so low that original cost far exceeded cost of reproduction. It was then contended that the consumer should not be compelled to pay rates based on such an arbitrary standard as the amount of money actually expended by the utility. It was urged that the cost of rendering the service should determine its price, and that the measure of cost was more accurately reflected in the reproduction value. Finally, it was argued that to permit a utility to charge rates based solely on the amount of money which it had spent, would be to permanently burden the consumer with any investment, however injudicious or unprofitable it might prove to be.

However, the Supreme Court in its decision repudiated this doctrine and held that the true legal and economic principles involved a consideration of all these factors; that if the rate base were determined solely by one or the other element of value, it might work injustice either to the consumer or to the utility.

Today the general price level is so high that the situation

¹ 169 U. S. 466.

is reversed, and as regards the great bulk of public utility property the cost of reproduction is greater than the original cost. Consequently many of those who claim to represent the public now contend that the rate base should be determined solely by the actual cost of the property.

It has been contended that if in 1898 the actual cost theory had been accepted, as the utilities then urged, the general increase in the price level in recent years would have given the utilities such a low rate base that they would have found difficulty in maintaining their service at the high standard of efficiency which the public requires. On the other hand, the reproduction cost theory is now bitterly fought by the same interests that urged its acceptance by the courts in 1898. This analysis points to the dangers of writing into our law a fixed economic theory which, by reason of a change in the price level, may act as a boomerang to those who urged its acceptance. The machinery of government must have some give-and-take, or it will not work. It has been pointed out furthermore that if the original cost theory were written into our law, the result would be to make more pronounced the evils of the so-called business cycle, by encouraging expenditures for improvements and expansion programs at times when prices are high, rather than in time of depression.

There are eminent economists who tell us that the real source of the difficulty is in unstable prices. They assert that whatever method is adopted we shall still have a continuance of confusion and waste until we have diligently and earnestly addressed ourselves to the problem of stabilizing the general level of prices.

Enlightened leadership among public utilities is coming to recognize that in the matter of rates the interests of the companies and the interests of the consumer often are not only consistent but are almost identical. If rates are substantially too high, consumption is materially decreased. On the other hand, if rates are too low, the industry is deprived of the capital which is necessary not only to insure the proper service standards and maintenance, but also to provide improvements and extensions in the service.

There are those who assume that within a limited area the demand for electrical energy is fairly constant. However, if

the testimony of practical operators is to be believed, the opposite appears to be the case. The consumption of energy in the average household varies with the belief in the consumer's mind that rates are fair or unfair. If he thinks that the rates are unfair, he begins to cut down his use of electricity and abandons the use of various electrical appliances. The situation may arise where rates are within legal limits but are more than the energy is worth, and the company can afford to lower the rates since that will result in promoting the use of electricity and in improving public relations. There was testimony given to the effect that many public utilities today are charging rates which are less than they might expect to obtain under decisions of the courts, either because of competitive conditions in the industry or as experiments in creating increased demand for the services. That such experiments have not been conducted on a much larger scale may be due not only to a lack of universal acceptance of these principles by the utility executives, but also to the lack of coöperation on the part of state officials.

When we speak of coöperation, I am again brought to the thesis of the report which I submitted as counsel to the Commission on Revision of the Public Service Commissions Law. In this whole question of regulation we are engaged in a task of statecraft. We are face to face with problems which cannot be solved by the reiteration of formulas or by enlistment in a moral crusade. It is a task which requires reconciliation of the basic interests of the state and of our economic institutions to insure that these institutions shall be the servants and not the masters of the public. The spirit of approach to that task is of the utmost importance. There are those who are so indignant at the exploitation of the public by certain of the utilities that they would use coercion to such a point as to compel utilities to yield what may be said to be their rights under the decisions of the court, or else to have penalties imposed upon them. That is a method of intimidation rather than of regulation. It is provoked by anger rather than by common sense. It can result only in increased irritation, protracted litigation, and in the end antagonisms that can produce nothing but economic waste. This method is not in the public interest. Instead of enlisting the support of the intelligent and honest utilities, it

would unify them with the unintelligent and shortsighted utilities. It would prevent intelligent leadership from asserting itself. It would place a premium upon political exploitation of an economic problem.

If it is agreed that this method belongs to the eighteenth century and is not applicable to modern conditions, then we are brought face to face with two alternatives, public ownership, or regulation with full coöperation between the utilities and the state. When we speak of public ownership it ought not to be spoken of as a threat or as a bluff merely, but as a proposed method which must be judged upon its merits.

So far this method has been rejected not only because of the practical financial burden of taking over the utilities, but also because of the belief that it would tend to destroy initiative and would be productive of inefficiency and perhaps corruption. Because of these evils the people have hesitated to accept the principle of public ownership and have sought to maintain individual enterprise, under proper control. The great problem is how to attain that control. It can best be attained not by a coercive discipline but by a self-imposed discipline, and that kind of discipline means coöperation. To have that coöperation there must be an appreciation of a reciprocal obligation on the part of the utilities and of the state. That relationship can come only from an established basis of mutual confidence. The leaders of public utilities must accept the principle of partnership and actually apply that principle. That the relation between the utility corporations and the public they serve, however it may be regarded legally, is ethically a partnership, has not been sufficiently emphasized. The public makes certain contributions to that partnership. It furnishes protection to the company. It confers the right of eminent domain. It grants numerous franchises and special privileges and monopolies in return for the service rendered. This partnership implies, then, that the leaders of utilities are only economic servants of the public, as the state officials are the political servants of the public. It is incumbent upon the utility to remove public hostility and suspicion by a scrupulous regard for that partnership and it is likewise incumbent upon officials of the state not to do harm, by political exploitation of the utilities, to the utility

industry and to the public which it serves. Such a method of coöperation is progressive because it is realistic. It does not conform to obsolete formulas but rather to actual needs of existing conditions. Today in the international field it is urged that because of the higher standards of civilization we should substitute the conference table for the battlefield. In the growing maturity of our economic civilization the time has come to substitute the conference table for the battlefield of litigation and the political rostrum.

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THE COURTS AND COMMISSION REGULATION

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IN recent months, the regulation of utility rates has been a most engrossing topic of discussion. There has been so much confusion, and apparent misunderstanding, as to the part played by the courts in rate control or rate regulation, that something said in clarification should be opportune. The legal theories and technique of procedure for ascertaining what is a case of confiscation of a business devoted to a public use or service, are of interest to both the student of law and the economist.

The appeal of a utility from the decision of a commission's order to a state court brings into question aspects which differ from the appeal which may be made to a federal court. The plea to the state court by a company may urge that the commission's order not only violates that tribunal's statutory duty to fix reasonable rates, but that it is contrary to the due process clause of the federal constitution, because it denies to the company a fair return in earnings.¹ It raises no federal constitutional question unless it be confiscatory.² The review in the state court is, in nearly all cases, set forth in statutes of the state. The plea to the federal court is granted upon the right to injunctive relief to prevent the state commission and the attorney general of the state from enforcing the order claimed to be confiscatory and thus preventing the charging of a confiscatory rate.

Article 3 of the Constitution of the United States provides that the judicial power of the United States shall be vested in one Supreme Court and in such inferior courts as Congress may, from time to time, ordain or establish. Section 2 of that article provides that the judicial power shall extend to all cases in law and in equity arising under the constitution and the

¹ *Chicago, Milwaukee & St. Paul Ry. v. Minn.*, 134 U. S. 418.

² *Banton v. Belt Line*, 268 U. S. 413.

laws of the United States. And the Fourteenth Amendment forbids any state to make or enforce any law which shall deprive any person of life, liberty or property without due process of law or deny to any person within its jurisdiction, the equal protection of the law. It is the deprivation of property without due process of law, that warrants the public utilities to make contest against any state regulatory bodies created by statute when the rates fixed by these bodies constitute a confiscation of property.

As long as there is a district court of the United States which has been ordained and established, the injunctive power will survive and may be used by any utility in protection of its property where an attempt is made to fix rates which, if enforced, would amount to confiscation of property. It is difficult for any student of the law, certainly impossible for a constitutional lawyer, to conceive of any way that Congress may take from the federal courts their power and duty to protect property about to be confiscated by regulation of any state or municipality.

The law has placed safeguards about the constitutional protection given property. In rate-making controversies or whenever the constitution is brought into question in a case in the district court of the United States, the law requires the judge presiding to call to his assistance two other judges, one of whom must be a Supreme Court Justice or a Circuit Judge, and so there is formed the so-called "statutory court". This is provided for by the U. S. Civil Code, §266. The law provides a direct appeal, as a matter of right, to the Supreme Court from any decision rendered by the so-called "statutory court". The Supreme Court has established very definite rules for the judicial process, once it is put into operation, in confiscation cases.

Rate-making and, more strictly speaking, rate regulation by public authority in the United States, was established more than half a century ago. On March 1, 1877, in *Munn v. Illinois*, the Supreme Court for the first time decided that private property devoted to public use is subject to public regulation, and it was more than two hundred years prior to that time that Lord Chief Justice Hale of England pointed out in a treatise, *De Portibus Maris*, that when private property is affected by public interest, it ceases to be private property only.

The efficient and impartial enforcement of the rights of a state or municipality and its inhabitants, in order to obtain adequate service at fair uniform rates, is just as essential as, if indeed it is not more necessary than, providing the necessary power and authority in the first instance, to insure such service for itself and its citizens. The strict, persistent enforcement of the law and the franchise or contract rights available to the municipality, and the rights of its inhabitants under undeterminate permits and commission regulation, is generally found necessary to secure satisfactory service at a fair uniform rate.

The underlying principle is that business of certain kinds holds such a peculiar relation to public interest that there is superinduced upon it the right of public regulation. The law has long been established providing a fair return on a rate based on capital invested in property devoted to and used in public service. The rate of return must be fair. The right to regulate rates is based fundamentally upon the exercise of the police power of the state. That is the power of government which is inherent in every sovereignty. It is the power to govern men and things, and while it is exercised for the common good, the police power of a state is not unlimited. Its use is always subject to judicial review, and when exercised in an arbitrary or oppressive manner, it is without due process of law, and such action may be annulled as violative of the rights protected by the Constitution. Therefore, it is observable that in granting this protection of the national Constitution, the questions involved are essentially questions of federal law and particularly of injunctive relief, both of which are primarily subjects for interpretation and construction by the national courts.

The selection of a federal court instead of a state forum for litigating these controversies as to rate orders has caused in the past, as it has recently, much public resentment. The cry of interference by the national courts has been loud and wide. But this antagonism to the exercise of jurisdiction has been the exception and not the rule, for the books are filled with reported cases in which recourse to the federal courts has been had and approved by authoritative decisions of the Supreme Court. That court in *Wilcox v. Consolidated Gas Co.*¹ in

¹ 212 U. S. 19.

1909, put the question of the right to appeal to the federal court at rest by saying:

At the outset it seems to us proper to notice the views regarding the action of the court below, which have been stated by counsel for the appellants, the Public Service Commission, in their brief in this court. They assume to criticise that court for taking jurisdiction of this case, as precipitate, as if it were a question of discretion or comity, whether or not that court should have heard the case. On the contrary, there was no discretion or comity about it. When a Federal court is properly appealed to in a case over which it has by law jurisdiction, it is its duty to take such jurisdiction . . . and in taking it that court cannot be truthfully spoken of as precipitate in its conduct. That the case may be one of local interest only is entirely immaterial, so long as the parties are citizens of different States or a question is involved which by law brings the case within the jurisdiction of a Federal court. The right of a party plaintiff to choose a Federal court where there is a choice cannot be properly denied.

Nor does the claim of a remedy by an action at law in the state court¹ nor the right to punish for a crime² defeat the equity jurisdiction of the federal court. When the federal court's jurisdiction attaches, it is exclusive and may be protected by an injunction granted upon an ancillary bill. The court may proceed to determine all questions in the case, those involving state as well as federal law, as far as it is necessary to reach a decision.³

The objection to the federal court's jurisdiction based on the claim of a violation of the Eleventh Amendment to the Constitution, which forbids a suit against a state by a citizen of another state, has now been definitely overruled.⁴ Another objection made is that based upon §265 of the Judicial Code, by which the federal courts are denied jurisdiction to issue injunctions to stay proceedings in any court of the state, but this too was overruled in 1908.⁵

Rates for public utilities must be calculated on a rate base which is the fair value of the property devoted to the public service, used and useful, and such fair value is determined by

¹ *Smyth v. Ames*, 169 U. S. 466.

² *Packard v. Banton*, 264 U. S. 140.

³ *United Fuel Co. v. R. R. Comm.*, 278 U. S. 300.

⁴ *Reagan v. Farmers' Loan & Trust Co.*, 154 U. S. 362.

⁵ *Prentis v. Atlantic Coast Line*, 211 U. S. 210.

giving to all relevant matters such weight as may be right and just in each case. The leading case on this subject was considered by the Supreme Court in 1898.¹ There the public was asking that the rate base be measured by reproduction cost and the railroad companies were asking that they be allowed to earn on a rate base measured by the outstanding securities on their property, which outstanding securities, they claimed, represented their original investment therein. The court laid down the so-called "fair value rule", saying that reproduction costs would be unjust to the railroad because they would not reflect honest investment prudently made, but it was held that the basis of calculation as to the reasonableness of rates to be charged must be the fair value of the property being used by the company for the convenience of the public and that in order to estimate such value, the original cost of construction, the amounts expended in public improvements, the amount and value of bonds and stocks, the present as compared with the original cost of construction, the probable earning capacity of the property under the rates prescribed by statute, and the sum required to meet the operating expenses, were all matters for consideration to be given just and equitable weight under the circumstances. The court announced the rule that the company was entitled to a fair return upon the value of the property which is employed for public convenience and put forth the doctrine that the public is entitled to demand, on the other hand, that no more be exacted from it for the use of a public utility than the services rendered are reasonably worth. While many rate cases have gone to the Supreme Court since that decision, an examination of them will find that this pioneer case has been departed from very little. New considerations, of course, have arisen, and it is as to these that the court has formulated additional rules for the guidance of the public utilities commissions and the courts. A study of these cases convincingly shows that the court does not concern itself primarily with the question whether a particular method of valuation has been followed but with the question whether, upon the entire record before the court, it appears that a just measure for the rates under consideration has been adopted. The court considers each case in the light of its own particular

¹ *Smyth v. Ames*, 169 U. S. 466.

facts and adopts no exclusive yardstick for the determination of the rate base except that which is controlled by equity.

The Public Service Commission is not a court; it is a fact-finding body charged with the duty of administering the law. There is always a rate which is just and reasonable as between the public utility and the public, and it is this rate which the commission should strive to ascertain and order. Rates fixed by it must not be so low as to cross the line of confiscation and ordinarily they should not closely approach that line. On the other hand, they should not be so high as to be unjust and unreasonable. Rate orders, to stand the test of the court's power to review, must find support in the evidence introduced at the hearing. They cannot be arbitrary or unsupported by evidence. They must follow and not disregard both the law and the evidence; they must be reasonable and not capricious and they must prescribe rates which are non-confiscatory. They must not interfere with sound business judgment and good management on the part of the owners of the utility property. The rate-making power, being an exercise of the police powers of the state, is a legislative power. Therefore, it is through the rate-making function exercised directly by the legislature that a regulatory body is created to whom the power of making rates is delegated by the legislature. Thus it is that the police power of the state is exercised by the legislature through its agency, the regulatory body. But its action is limited by the Constitution of the United States and the constitution of the state where it functions. Of course, the regulatory body is further limited in the use of legislative power delegated to it by the requirement enjoined on it in the legislative enactment creating it. Therefore, a regulatory rate order is of the same force as the legislative enactment and is subject to the same limitations.

The Fourteenth Amendment of the federal Constitution through the due process and equal protection of the law clauses provides two important limitations of state legislative power. It is because of these that all legislative enactments and likewise all regulatory rate orders which are foreign to or infringe upon these two clauses or either of them, are void and may be annulled by an injunction in the federal courts. Moreover, all legislative enactments and all regulatory rate

orders which transcend the limitations of the state constitution and all rate orders which fail to meet the requirements enjoined in the enactment creating the regulatory body, are void. A regulatory body or commission is not clothed with the general power of management incident to ownership and it is not empowered to substitute its judgment for that of the directors of the company in the matter of operation. But in rate-making, in determining the rate base, it is also not empowered to substitute in whole or in part any other type or construction of plant for that under investigation.

The commission has no power to make findings and issue orders except upon compliance with the course of procedure and the rules and decision prescribed in the state regulatory law under which it functions. The commission's right to act depends upon compliance with requirements of the statute as to notice and hearings. It must grant a full hearing which must be adequate and fair and its findings must rest upon the evidence introduced and the evidence must show the existing or proposed rates to be unreasonable in order that they may be changed up or down, and failure on the part of the commission to make reasonable compliance with these statutory requirements invalidates the order. The commission has no power to lessen the value of utility property or to make deductions from its value on the assumption that customers through the payment for service are making contributions to depreciation or other expenses or to the capital of the company, nor because of some assumed relation existing between the utility company and its customers, for that does not exist.

These principles find support in the Supreme Court decisions and make it clear that the commission has no power to prescribe confiscatory returns or an inadequate rate of return. For this would be a violation of the due process clause and the limitation of legislative power. One thing is certain and it is that the commission engaged in fixing public utility service rates must give heed to the decisions of the United States Supreme Court in relation to rate-making and conduct such investigation or inquiry and authorize such rate orders as, under the decisions of that court, the utility company and the public are entitled to have made.

In recent years, the state, which is the depository of the

sovereign will and power of the people, has exercised its right to enter the business of furnishing public utility services. When it does, the public is entitled to the same protection as in the case of private ownership. At other times, instead of doing so and instead of exercising its right of government ownership, it sometimes provides for the creation of public service corporations and it grants to them the right to furnish utility service at a profit. It endows them with certain powers and clothes their business with valuable rights and privileges. These are creatures of the state. They live and exist upon the hypothesis that they will be a public benefit and confer benefits upon the public. They are not organized for the purpose of speculating in other properties, stocks or bonds. They perform a function of the state. Their very existence and their only powers, rights and privileges are derived solely from the state. They too are subject to regulation. In the private enterprise, the owner demands the highest profit obtainable and gets all he can. His investment is in the perilous field of competition. He must create his own market, procure his customers, advertise his business, assume all risks and receive no help from the state; and having received no such grants from the state, no valued rights or privileges, he is not obliged to ask only fair profits on the sale of his product to the public. His profit is limited only by the laws of competition. In the public service business, an owner is entitled only to what is fair and reasonable profit on the service he furnishes the public. The corporation is performing a function of the state. The business is permitted to be established for the benefit of the public as well as for the pecuniary gain of the stockholders. The investment is protected against competition and clothed with the privileges of a monopoly. The market is established, the customers have no choice, for they must use the service rendered. The corporation is given the right of eminent domain. It is allowed the free use of the municipality's streets; it is exempt from payment of franchise taxes; it has a uniform charge placed on the service and it is relieved from furnishing gratuitous service. It is protected from all grafting and is clothed with the right of emergency relief in time of distress. Such rights and privileges granted to the public service corporations are of great value and are

to be compensated for by benefits conferred upon the public by the public service corporations. These are economic reasons which form the basis of the decisions of the Supreme Court granting protection on the one hand and affording profit, and on the other hand restraining oppression and arbitrary and excessive charges.

Municipalities such as cities have often intervened in cases which primarily are between the public service corporation, the utility corporation, and the regulatory body of the state. While such intervention has uniformly been permitted, the Supreme Court recently in the *New York Telephone* case¹ laid down the rule that the relation between the company and its customers is not that of partners, agents and principals or trustee and beneficiary. In *Fall River Gas Co.*² it was said that the relation between a public service corporation and the public was not a partnership, but rather that of independent contracting parties. In the *New York Telephone Co.* case, the Supreme Court pointed out that customers pay for service, not for the property used to render it; that the payments were not contribution to depreciation or operating expenses or to capital of the company; that by paying the bills for service, the customers did not acquire any interest, legal or equitable, in property used for their convenience or in the funds of the company. That property paid for out of moneys received for service belonged to the company, just as does that purchased out of the proceeds of its stocks and bonds. But in a case where the inhabitants of a municipality are directly interested, the responsibility of protecting not only its own rights, but the rights of its inhabitants, rests upon the municipality. With a proprietary or business power to care for its own force and with a government or legislative power to care for the rights and welfare of its inhabitants, it has been considered proper to admit municipalities into such litigations where regulatory laws or where rate orders are being considered. Therefore, petitions to intervene by municipalities have been granted. Public utility corporations have a special interest for municipalities; they afford protection against fire, flushing the streets and sewers; street lighting, parking, boulevard light-

¹ 271 U. S. 23.

² 214 Mass. 538.

ing, water supply; gas at proper pressure and heating units. They furnish electricity of dependable constancy; street cars run on the public streets; and telephone service is a necessary requirement for not only the city, but its inhabitants, in the promotion of health, convenience and general welfare. A municipality's responsibility in exercising its legal right of participating in rate-making cases where it and its inhabitants are affected by the rates, is commensurate both with the value of the service and with the costs of the services to the user.

The principle that the rate base is the fair value of the used and useful property at the time rates are fixed has been universally established and recognized. That contemplates the time when the order fixing the rate is made by the utility board. Prices of labor and material and valuations of property devoted to the service fluctuate and change with the upward or downward trend of the prices.

Some utilities are not content with a fair return upon their investment, not even with a fair return upon the fair value of their properties. They seek to narrow the fair value rule laid down in the *Smyth v. Ames* case. They urge that dominance be given to reproduction costs and estimates of physical property and then augment those estimates with a long list of financial intangibles. The courts have been quick to stamp with disapproval such a list of intangibles. The rate-making case is always a contest between engineers, accountants and lawyers; a contest of wits in various directions.

But with all the efforts made to change it, *Smyth v. Ames* represents the rule today as it did in 1898, that fair value means, under all the facts and circumstances surrounding the particular case, what is fair both to the utilities and to the public. The Fourteenth Amendment, in protecting utilities' property devoted to public service, does not always protect the utilities' actual investment in the property.

In making rates and in claims of confiscation, the commission and the courts always make sure that the rates are to be for the use of the property, and it must be only such as is presently devoted to the public service. The value fixed in the appraisal must be only of that property which is an instrument of public service, and that valuation must be a reasonable value. The Supreme Court has pointed out that the ability

or sagacity of the owners of property need not be considered as an enhancement of its value.

Many relevant matters are weighed in the judicial determination of fair value. The judgment must be based upon a reasonable basis; it cannot be arbitrary or unjust. There is no particular rule or formula. Courts do not give dominance to any particular method of valuation, but to all relevant matters under the circumstances. They are concerned only in arriving at a rate base which is substantially fair and just, both to the utility and to the public. Some matters considered are the original cost of construction, the amount expended in permanent improvements, the amount of market value of bonds and stocks, the present as compared with the original cost of construction, the probable earning capacity of property under particular rates prescribed by the statute, the sum required to meet operating expenses, appreciation and depreciation, going value, the financial history of the company, the enhancement of costs and book values.

Going value is to be added to the plant as a whole, over the sum of the values of its component parts, and is attached to it because it is in active and useful operation and earning a return. Good will in the ordinary sense of that term, which means an element of value arising from a well-known business being favorably regarded by its customers, is not included in the valuation for rate-making. Going value does not include good will. The concrete measure of going value is generally the cost of attaching and developing the business over and above the cost of the construction of the plant. Franchises to do business are not valuable in order to enhance the value of the rate base. Working capital is a proper matter to be considered in determining the rate base. Depreciation must be considered as well as depreciation reserve.

What a fair return is depends upon the facts and circumstances surrounding the utility at the time of the inquiry. Some of these are the risks and hazards in the business, the location where the business is conducted, the rate usually realized upon equally stable investments in the community, the legal rate of interest, the money market and business conditions generally, the financial connections of the utilities and the management and operative experience of the utility. The

rate of return has varied from as low as six per cent to as high as eight per cent, depending upon these factors.

The courts cannot prescribe rates; they do not do so either in the state or federal courts. Rate-making is a function of the legislative branch of the government. The federal courts review rates to ascertain if the rate fixed is confiscatory, and to be confiscatory means that if enforced, they are regarded as depreciation of the property of the utility without due process of law. The trial courts exercise independent judgment in reaching their conclusions; they are not bound to accept the testimony before the utilities board. Usually a master is appointed who hears the questions of valuation and other material evidence entering into the subject to determine whether the rate of return is inadequate and therefore confiscatory.

The Supreme Court has complete freedom in reviewing each case. A review is an absolute right of either party.

In the state court proceeding, testing the validity of the commission's order, the procedure is usually regulated by statute. It is a review, usually of the validity, upon the record made before the commission. Upon the filing of the petition for judicial review, the commission certifies to the reviewing court the record of the proceeding had before it, which formed the basis of the order questioned. The state court must judge the validity of the commission's order upon that record. In some states, there are statutes forbidding the reviewing court from considering other or additional evidence and these have been held valid under the federal Constitution.¹

The commission's findings of fact, unless arbitrary, are considered conclusive and some decisions forbid a judicial review upon any ground, before the commission has been petitioned for a rehearing. But in confiscation cases, the state court must reexamine and judge independently the facts upon which the commission's orders rest. The power of the state court to afford temporary relief is limited to the suspension of the commission's order *pendente lite*. The taking of an appeal does not operate automatically to stay the commission's order. But the court may grant a stay and when it does so, it usually requires a bond protecting rate payers, and some-

¹ *Oregon R. R. & Navi. Co. v. Fairchild*, 224 U. S. 510.

times the rates fixed by the commission are ordered impounded under the direction of the court.

It is thus observable that the record before the state tribunal is different from that before the federal tribunal and the validity of the order must be judged accordingly. If the company seeks review by the Supreme Court of the United States, it is at a disadvantage when depending upon the record before the state tribunal, and an effective appeal to that court is rarely possible. The review from the state court is hazardous and that is the reason for the more frequent appeals to the federal court. Moreover, in the plea to the state court, it must pass through the highest court of the state before an appeal may be taken to the Supreme Court of the United States, whereas from the federal district court an appeal may be taken direct, and this is a gain in the matter of time which is all-important, both to the rate payer and to the company claiming confiscation. In the federal courts, if *prima facie* the rate appears confiscatory, a temporary injunction against its use is granted. The same is true in the state court, but the scope of temporary relief in the federal court is broader and permits an immediate increase in the rates. The refusal of the state court to stay the commission's order, not being a final order, is not ordinarily open to review, whereas in the statutory court procedure, there is the absolute right of appeal from the temporary injunction issued. The state courts may only affirm or set aside the commission's order and remand the questions to the commission for further proceedings. If the commission's order reduced the company's rate from those previously charged, then the scope of relief afforded by the stay of such an order is amply broad, but if the utility has applied for an increase in the rates, an increase which it regards as vital to its existence, a stay of that order would do considerable harm in preventing the increased rates. A success in the state Supreme Court would therefore, be of little benefit, if three years later, the order denying the increased rates were held to be unlawful or should be set aside. During the period of the appeal, the company might suffer from an unlawful order and could not be reimbursed for the consequent loss it would sustain. Indeed, economic and social conditions might have changed in the interim. There are no

such limitations in the relief which may be given in the federal court. It may declare the order fixing rates confiscatory and unconstitutional and enjoin its enforcement. It may properly enjoin the commission from interfering with the company's putting into effect schedules of increased rates.

Nor is there any basis for the recently repeated charge that the law as applied by the federal courts in rate cases is destructive of effective state regulation and that, therefore, review in the federal court is undesirable. Most confiscation cases are governed by the decision of the Supreme Court of the United States applying the due process of law clause, and this authoritative source is as binding upon the state court as upon the federal court.

The impression sometimes conveyed that the courts, particularly the federal courts, have hampered or interfered with state regulation by reversing or refusing enforcement of the orders of the commission, is not well founded. From the magnitude of the discussion recently had in New York State, one unfamiliar with the facts might gain the impression that the commission's duty of regulation has been hampered by an increasing judicial interference with its orders. The analysis made for counsel for the Commission on Revision of the Public Service Law, referred to by Colonel Donovan,¹ and which appeared in the minutes and exhibits of the hearings before that body, fully answers any such charge. From 1921, when the present Public Service Commission was created, through 1928, the commission is shown to have made some 11,440 final orders in proceedings before it. These final orders were in addition to many thousands of matters disposed of without formal proceedings.

Of the 11,440 final orders of the commission since 1921, only 46 were ever brought into question before a court by any party interested and only three of these were taken to the federal courts. During the same period, the commission made 981 rate-fixing orders, and only one of these was set aside by the federal court. Only nine out of the 981 rate orders were reviewed by any court, state or federal. Four of the nine were reversed by the state courts, and one was set aside by the federal courts; the others were affirmed by the state courts.

¹ Cf. p. 174.

No order of the Public Service Commission as to service, improved or extended facilities, the issuance of securities, or the granting or withholding of any required permission or authority, was set aside or disturbed by the federal courts during the life of the present commission. One order, requiring a large extension of gas mains, was affirmed by the United States Supreme Court. It is thus demonstrated that during the entire life of the present Public Service Commission there have been very few instances of federal review of the commission's orders, and there has been no crippling of the commission's regulation by review or reversal of the commission's order, by decree of either state or federal courts.

It is thus clearly established that the constitutional guarantee of protection with the precautions in the procedure administering it, has been wisely given to the public and the utilities, whenever an order of the Public Service Commission has been brought into question; and the public may confidently rest within the security that justice will be done in any controverted matter which reaches either the state or the federal courts.

THE FUTURE OF POWER SUPPLY AND PUBLIC CONTROL

FLOYD L. CARLISLE

Chairman, Niagara Hudson Power Corporation

IT is very difficult for me to credit those in violent dissent from the present basis of rate-making and regulation with a sincere desire for any regulation. They are at heart for government ownership and operation, but fear to advocate it openly. Their cry is that if we cannot have our own kind of regulation, then reluctantly we shall be driven to government ownership. When they attack the present basis of rate-making, which has been repeatedly affirmed by our highest courts, these gentlemen must, if they are really honest about it, know that their criticism is not against regulation, but against the Fourteenth Amendment to the federal Constitution and similar provisions of the constitutions of the various states. Therefore I say that the innumerable theories of a different kind of rate base and a different kind of regulation that run counter to the law of the land and that have no conceivable legal hope of becoming the law of the land, are really not sincere efforts but are back-handed methods of leading up to government ownership. Personally, I would prefer to see such persons come out frankly, if they will, and take their stand in the open, letting the truth and light in and letting the people understand what it means in condemnation values and in annual bond issues.

While no exact figures are available, I feel very certain that to take over the gas and electric properties within the State of New York would require at least \$4,000,000,000. Are the advocates of government ownership prepared to recommend bonding the state or subdivisions of the state for that amount or whatever amount may be determined in the end to be the correct one? Are they prepared to recommend the annual raising by bond issues of from \$150,000,000 to \$250,000,000 per annum for normal growth, to say nothing of the billions

required if the great water powers with their attendant transmission lines are to be developed?

Are they prepared to tell the people the truth about the enormous loss in taxes to the state, to municipalities and to the federal government which would follow state ownership and operation? The public utilities are annually paying in all forms of taxation from their own treasuries approximately \$25,000,000 to the towns, villages, cities, counties, state and federal governments. In addition to this amount, the companies are paying interest on bonds and dividends on preferred and common stocks of approximately \$150,000,000 per year, which sum in turn is subject to the payment of taxes by the persons or corporations receiving it; and while no figures are available, I estimate the revenue received by the various governments from this source at approximately \$15,000,000. The amount which the governments receive from death dues or inheritance taxes varies from year to year but is another very large sum, probably averaging \$10,000,000. Stock-issue and stock-transfer taxes constitute another large source of revenue to the state. Are the advocates of government ownership prepared honestly to tell the people how they expect to recover \$50,000,000 of annual taxes which will not be collected under government ownership?

Will they frankly tell the people that if the utilities under government management fail to earn as much as under private management, the decline and difference must be made good by taxing the house, the farm and all other properties in the state? The advocates of government ownership are all advocates of much lower rates than are now being charged. Lower rates will mean less income. Will they tell the people that this diminished income can only be made up in the form of added taxation from other sources? Will they also frankly tell the people that if by any chance science evolves new and cheaper means of generating and distributing electricity the state or municipalities bonded for \$4,000,000,000 plus, to take over the present companies, might be in a position of paying for a dead horse? That is exactly what would have happened had the state taken over the interurban railways whose economic status was changed by the automobile and truck. Will they tell the people that the only means which the state and municipalities

have for meeting deficits and paying the principal of bonds and their interest is through taxes levied upon the property or income of the citizens of the state or municipality?

Will they furthermore tell the people that the money to purchase the existing public utilities and the money needed in the future for their expansion must come by the sale of state or municipal bonds to the investors of the country? Will they tell the people that these investors are exactly the same institutions and people who now buy and own the public utility securities? There will be no change in the source from which the money comes and there is no magic in the name of the state or municipality to command a different market. The people, after all, who must put up the money are the people who accumulate savings sufficient to make new investments. These people would not buy state or municipal bonds at all if the undertaking were not profitable, and if the quantities of state bonds issued were far in excess of those now outstanding, their rate would advance and security would necessarily lessen. Assuming that the state itself took over the existing utilities and issued bonds free from taxation to the present owners of their securities, nothing would immediately happen except that all of the securities now outstanding would no longer be available to be taxed, and that the risk and hazard of the utility business would be shifted from the investor himself to the state, and the state would have no means of paying such debt or the interest thereon except through its ability to tax the property within its borders and the income of its citizens.

What justification is there for the charge that it is necessary for the government to take over the public utilities? I wish there were a critic in this country fair enough to admit the truth that the best job done in the United States in the last fifteen years has been the job of the electrical utilities. Against rising taxes, higher costs of labor, higher costs of materials, it has been the one industry that has put its selling cost down.

This year it is spending \$800,000,000 for new construction. I am very sure that at least \$500,000,000 of that goes directly or indirectly in the form of wages. What does \$500,000,000 in wages sustain? At least 250,000 people working, and if there are four people to one family, at least 1,000,000 of our population are living and prospering due to the fact that the

electrical utilities can raise the capital annually and can buy these electrical machines, these transmission lines, this copper, this steel, this wood, this cotton, this rubber, in the enormous quantities that enter into the uses of public utility construction programs.

The critic of the present scheme of things answers the argument against government ownership by saying "What about the Hydro-Electric Commission of Ontario?" This is a perfectly fair question to ask and a proper one to answer. I wish to preface my remarks regarding the commission with a statement that I have the highest personal regard for the ability and honesty of its members and for the Government of Ontario. Our company transacts business with the "Hydro" satisfactorily to us and we hope to it, and the arrangement is mutually beneficial. I believe the commission to be the best managed and operated government enterprise in the world. So far as I know, the commission itself has never sought to compare its operations with those of privately operated utilities in the United States. It has never claimed that it was doing a better job than the private utilities. It is engaged solely in the particular job at hand and is not seeking to have its methods adopted elsewhere.

With this preface, let me pass to the actual figures of economics. In the year 1928, the last available record, the Hydro sold within its own borders 3,061,545,371 KWH for \$32,431,648. In that same year, the Buffalo, Niagara and Eastern group of companies, being quite comparable with the Hydro in location, sold 4,436,403,784 KWH for \$32,911,782. The entire Niagara Hudson System sold 5,913,543,327 KWH for \$62,688,860. The Hydro Commission and its associated municipalities paid substantially no taxes to the government. For the year 1928 the American companies in the Niagara Hudson System were taxed \$10,118,867 and in the Buffalo territory alone, \$4,546,413. No critic of present regulation could possibly take exception to our deduction of taxes to make the figures comparable. On this basis, the American companies in the Buffalo, Niagara and Eastern group received 6.4 mills per KWH for all energy sold, whereas the Canadian commission received 10.04 mills. In other words, the American companies delivered their energy to the users of electricity of all

classes at a price averaging forty per cent under that of the Hydro. This, plus the fact that in a comparison the Hydro was favored in drawing all of its energy from water power, while twenty per cent of the Buffalo, Niagara and Eastern's energy had to be produced by steam.

The figures which I have given are all conclusive on an overall comparison of the two systems, but the critic says, "Your household rates are higher." Yes, this is true and must necessarily be true in a system that pays taxes and is run from the standpoint of treating all classes of consumers fairly and equitably. In 1928, the Niagara Hudson householders paid \$14,937,189.91 for their electricity. If the companies had paid no taxes, we could have furnished the electricity for \$4,818,322.91 and made as much money for our stockholders, and the household consumer would have received his electricity at less than one-half the price paid by the household consumer in Ontario. The power rates in New York State have attracted enormous industrial expansion; in fact, they have made the state the greatest center for the use of power in the world. The Province of Ontario has not been able to do this. The new growth of the output of the American companies for industrial uses in the year 1931 will be greater than the entire pure industrial use of the Hydro of Ontario after twenty-one years of existence. Measured by any standard of comparison, when consideration is given to taxes paid, our New York State companies are selling power cheaper and building up their communities much more rapidly and have infinitely better hopes for the future than lie within the Province of Ontario.

I have spent most of my time answering the critics. I never was by nature one to be on the defensive. I see the opportunity in this state to do the most constructive job possible in the United States as it relates to power. Cheap electricity never can be established by passing new or different laws. The generation and sale of electricity is primarily a business. By far the greater part of the electricity generated must be sold to industries that are changing their character, and demanding continual adjustment to changing conditions. New processes for using electricity and cheaper costs of purchasing electricity require the generating and selling companies to meet very real competition, else they lose the greater part of

their business. The question of rates and public control arises solely in the selling of electricity to the householder and farmer. These sales are but a small part of the total. It would be impossible, however, to separate the household lighting from the industrial lighting without adding greatly to the cost of each class of service. The real hope for lower rates in this state lies in the greater industrial uses of power.

New York State has been singularly blessed by Nature with cheap water power. The great drop at Niagara Falls, with a dam created by Nature, backed by a drainage area of the whole Great Lakes section, will always stand out as one of the cheapest, if not the cheapest, development possible. Approximately twenty per cent of the water at Niagara Falls is now used for power purposes. Without injuring the scenic beauty, very much more water could be used than at present. Such water ought to be used and such water used will attract new industries, building up great payrolls, and pour millions into the state and national treasuries in the form of taxes. Furthermore, the industries using this power will be soundly grounded in that they will have the cheapest possible source of generation.

The next great source is the St. Lawrence River. By reason of the fact that a dam must be built across the river under great engineering difficulties, and the fact that the drop in the river at the Long Sault Rapids is but approximately 85 feet, obviously that power will cost much more than the power at Niagara Falls. I do not intend tonight to discuss the merits or demerits of the position taken by the Governor of the state, but to touch upon it in passing as follows:

The Frontier Corporation, a subsidiary of Niagara Hudson, owns the substantial riparian rights on the Long Sault development. We believe that these riparian rights constitute the real ownership of the right to use the falling water for power purposes, that the State of New York has no ownership whatsoever in the water power upon the St. Lawrence and that the federal government has no such ownership. It has been perhaps unfortunate for everybody that repeated assertions have been made by those in high authority that the state itself owns the water power on the St. Lawrence River. I am in hopes that the commission which the Governor will appoint will

answer that question early in its deliberations or if there is doubt about it, have it settled by a friendly court proceeding, so that the people of the state may be truthfully informed of the ownership of the right to the water for power purposes. In saying this, I am not antagonistic to a plan, if it could be worked out, in which the state, through a corporation to be created, would be a party. The complications with governments at Washington, Albany, Ontario and Toronto are no light matters, but our companies are not set or rooted to any one plan and are approaching the whole problem with open minds and a disposition to be helpful and considerate of every interest involved. The big thing is to get the power developed. The value of a commission investigation will lie in the ability of the commissioners and in the thoroughness of their work and report. This matter should have no political cast. It is one purely of business. From that standpoint we are completely committed, the sole end in view being to cause the power to be developed and sold at the cheapest price.

The third thing that should be done is to put the inland streams to work. Here there is no question of government ownership. The only relationship with the state is the facilitation of storage reservoirs which are necessary in order to have the power available for distribution and use by the householder and farmer.

If these three great sources, Niagara Falls, the St. Lawrence and the inland streams could be developed, 16,000,000,000 KWH of the cheapest hydro power possible in the United States could be developed. Last year the total used in the state was approximately 12,000,000,000 KWH. If this hydro power can be developed cheaply and sold cheaply to industries, this state can have a tremendous industrial growth and that growth will be rooted in soundness. No other state in the Union has a future even approximating this. The sole question is: Are the citizens of this state able to divorce these sources of cheap water power from politics and have them treated upon an honest business basis? If that can be done an era of growth and prosperity greater than ever given any American commonwealth lies before us. Development of this cheap power is the true and practical way to lower household rates in this state and to keep them low. I doubt whether

there has ever been a law passed since the beginning of time that really lowered the price of any commodity or for any period of time fixed it or controlled it. Economic forces alone are at the heart of business. Regulation of public utilities can only be for the prevention of unfair and discriminatory rates. Regulation itself never can make rates. If the Public Service Commission of the state requires the companies to adopt some new rate schedule for the sale of power to industry, such a tariff would not bring us a single new customer and undoubtedly would drive many an old one away from us. If the government took over the public utilities, the first thing that would happen would be that the manufacturers now buying their power would start building their own plants to generate power, because they would not dare rely upon politicians and the changing administrations for so vital and necessary a part of their business. Personally, I see no difficulty whatever about securing lower rates and better service in this state, provided we can use the great undeveloped water power resources as they should be used. The hope of the consumer in the State of New York does not lie in a multiplicity of new statutes and new theories. It lies in the economic sources that we have, plus a standard of morality in the management of the corporation that truthfully has a public point of view as well as a private one. Sound economics and able, public-spirited management are the only things that can produce lower rates.

The objectives of public utility companies should and must be to give the best possible service at the lowest possible rates. Such rates must be sufficient to give to the investors in the companies reasonable certainty of return upon the fair value of the property rendering the service and to attract the tremendous amounts of new capital needed annually for expansion. Such rates must be high enough to permit the payment of adequate and equitable taxes to the local, state and national governments, to permit proper depreciation, obsolescence and adaptation to the constant changes and new discoveries occurring in the electrical business, and to permit the payment of fair and remunerative wages and salaries to the employees of the companies and to care for them when injured, sick and aged.

To attain these objectives it should not be necessary to resort to continuous rate cases and court reviews. The doors of the company should be wide open to its consumers, to municipalities and to the commission to discuss and receive information concerning the company's business. State commissions possessing the power to fix rates cannot and should not function as prosecuting attorneys. The road to low rates and good service should not be a battlefield, political or legal. Public Service Commissioners' work must largely be fact-finding and their acts must be within rules and precedents, otherwise such acts will be futile. Such commissioners must have the courage to stand by the companies when right, in the face of criticism and political interference.

The companies are powerful instruments for great good or harm to the communities which they serve. The possession of this power is a great responsibility which must be exercised for the building and benefit of the communities.

This all presupposes the highest character of management, honesty, ability and fairness, and a public, as well as company point of view. It equally presupposes frankness and dealings conducted openly and where possible, publicly. The cure for unjust and selfish political interference, for well-meaning but ignorant criticism and for the assault of the demagogue is not silence, but frankness and the truth, told in the open forum.

THE REVISION OF THE PUBLIC SERVICE COMMISSIONS LAW¹

HON. FRANKLIN D. ROOSEVELT

Governor of the State of New York

WHEN history is written the Legislature of 1930 will always be remembered as having taken one great step and opened the door towards another great step.

The first was the passage of the law authorizing me to appoint a commission to use every effort to bring in a plan for the development of our electrical resources on the St. Lawrence under a state agency, rather than by a private corporation. I have spoken several times before of the details of and reasons for this important state policy and I refer to it now only because it has a somewhat close bearing on the general subject of cheaper electric light in our homes, and I hope that you will bear the fact of the St. Lawrence policy in mind when you discuss the even broader subject of the state's general policy towards what are known as public utilities.

Let us go back about fifteen months. Early in 1929, there was a general agitation in many parts of the state over what was considered by many to be the failure of the Public Service Commission to function as it had been intended to function when it was first established under the administration of Governor Hughes in 1907. At that time, twenty-three years ago, Governor Hughes, fortified by his experience in the astounding revelations of the insurance investigation, obtained from the Legislature the creation of a Public Service Commission which

¹ Governor Roosevelt was most cordially invited to speak at the semi-annual dinner of the Academy. After the date for this meeting had been fixed and invitations issued, the New York Legislature determined upon the same day, Friday, April 11, as the date for its final adjournment for the 1930 session. Under the circumstances, Governor Roosevelt felt that he could not be absent from Albany that evening. He kindly consented, however, to the inclusion in this volume of an address which he shortly afterward delivered by radio on the subject he had been invited to discuss before the Academy. This contribution, as revised by Governor Roosevelt for the purpose of publication here, assures that this volume includes an authoritative presentation of his views.

was intended to supervise the activities of utility companies of various kinds. Up to 1907, the Legislature itself had from year to year sought to supervise utilities by stating maximum rates,—an unsatisfactory system which resulted in log-rolling, lobbying, and actual bribery in the legislative halls. Governor Hughes and everybody else in 1907 recognized without question that there is a very great distinction between wholly private industrial companies dealing in commodities like steel or shoes or clothing or groceries or flour or automobiles or farm implements or running department stores, and on the other side, semi-public corporations dealing in service to the public such as gas, electricity, street cars, etc., in other words, services which might and probably would result in monopolies. There was no question that the state had the absolute right not merely to regulate these public utilities and to supervise their methods of carrying on business, but also to give or deny to them the right to get charters except on terms laid down by the state. The Public Service Commission, therefore, was created in the days of Governor Hughes to act not as a court as between the public on one side and the utility companies on the other, but to act definitely and directly for the public, as the representative of the public and of the Legislature, their sole function being to supervise the utilities themselves under definite rules. That is a very clear statement of the common law principle which goes back hundreds of years in the civilization from which we spring. Keep that distinction in mind when I speak of the next events.

Gradually from 1907 on there had come about forgetfulness of the Public Service Commission's primary function. Gradually the commission had come to consider itself more and more as a court and many of the public had come to think of a utility company as very similar to any corporation engaged in private business as distinguished from public service.

As a result of the agitation early in 1929 a commission was appointed consisting of six members of the Legislature and three commissioners appointed by me. This commission held extensive hearings last autumn and until March, 1930. The six legislative members brought in last month a series of over thirty bills. Let me tell you first what these bills did. All but ten of them may be dismissed with the simple statement

that they are of distinctly minor importance, relating chiefly to changes in language and small modifications in the Public Service Commission's procedure. Of the other ten bills which were of some importance, one gives authority for the first time to the Public Service Commission over holding companies; one bill proposes a new method of appeal to the Appellate Division by companies which are not satisfied with the Public Service Commission's rate-making; one bill creates a Bureau of Valuation and Research; and another seeks to set up a people's counsel in the office of the Attorney-General. The bill to create a so-called people's counsel, I vetoed yesterday on two very simple grounds. The first is that the Public Service Commission itself ought to act as the people's counsel and should be given all the legal, engineering and accounting assistance possible to this end. Secondly, there would be a division of responsibility if both the Attorney-General's office and the Public Service Commission were charged with the protection of the people's rights in utility matters. All of these bills passed both houses of the Legislature but two others, extending regulation, got lost between the Senate and Assembly during the rush of the final night session and did not pass the lower house. These were the bill to provide for regulation of private water companies, and the bill providing regulation of the practice of submetering electric light to tenants of large buildings. I wish that the public and I could some day learn the true story of where and how these bills got lost. I think it would make interesting reading.

It is greatly to be regretted that the Public Service Commission was not given authority over private water companies, because, though few people realize it, a very definite drive is now being made by promoters and others to buy up private water companies and even the municipally owned water companies in many parts of the state, in order to create new holding companies which through their financing arrangements may be turned into gold mines for the promoters, even though they are not always gold mines for those who buy the stock.

Now we come down to the meat in the cocoanut—and here is where my friends in the Legislature made what I honestly and sincerely believe to have been a very grave error of judgment and a very grave failure to understand the overwhelming

demand for the laying down of a clear and well-defined state policy about utility companies and their rates. I refer to two bills introduced by the legislative members of the investigating committee, the valuation bill and the contract bill.

The first when introduced proposed a definite valuation by the Public Service Commission of the property of all the utility companies of the state over a period of years, but did not set up in any way any policy or clear-cut definition of how the valuation was to be made. The purpose of valuation is, of course, to find out how high or low the rates charged to consumers should be in order to give the utility company a fair profit. I objected to the bill from the beginning because it failed to set up any distinct standard for the valuation. In the closing days of the session, after protest by the utility companies, the legislative leaders amended this measure by making the so-called valuations wholly discretionary, thereby pulling out the few remaining teeth in the bill and making it, in my judgment, absolutely valueless.

The other bill, also weakened in the closing days of the session, is equally a mere gesture by the Legislature, and I do not think it is worth the paper it is written on or the cost of having it printed. It represented originally a half-hearted attempt to provide for voluntary contracts between the Public Service Commission and the utility companies by which a company might come to some kind of an agreement on valuation, this to hold good for ten years. It was perfectly clear at the hearings that the utility companies would not enter into any such contracts unless they could get what they thought were wholly satisfactory rates, and there was nothing to compel them to make the contract. It was indeed stated that they had no intention of making any contracts whatsoever with the Public Service Commission. In the closing hours of the Legislature this bill was practically stricken out and the new bill substituted providing that municipalities may, if they can—and let me stress the words "*if they can*"—make ten-year rate contracts with the utilities doing business within their borders. There is nothing new in this provision. It has been tried out in the past with street railroads and has proven practically useless. This bill is also a mere gesture and means less than nothing at all.

The above is a simple statement of the way the mountain labored and brought forth a mouse, and this in spite of the fact that nearly one hundred thousand dollars has been spent trying to provide some really useful legislation.

Nevertheless I feel that the money and the time have not been wholly wasted, because more and more people are taking a greater interest in the whole subject of public utilities and the more discussion there is the more the public will realize that the time is at hand for this state, and most of our sister states, to take definite and positive action.

The three minority members of the investigating commission, in the hearings and in their recommendations, went to what is really the root of the public utility problem. They pointed out the simple truth that the major problem of restoring proper supervision of utilities centers around the question of valuation for rate-making purposes. The question is whether the great utility companies are under present methods rendering regulation ineffective by insisting they are entitled to profits rated on inflated valuation of their properties and by starting long-drawn-out controversies in the courts when they do not like the rates granted by the commission.

The Minority Report signed by Commissioners Walsh, Bonbright and Adie is a model of clarity and will for many years be used as a kind of textbook throughout the United States. They say that the only way to assure reasonable rates for electric light, telephones, etc. is to establish by statute a definite declaration on the part of the people of the state, who grant the charters under which these companies operate, making it clear just what elements can be used to set up the rate base, these elements being composed essentially of the actual cost of the necessary properties, i. e. the actual cash put into the utilities by investors. Such a rate base becomes fixed and on this rate base and no other a reasonable rate of return should be allowed to the utility.

Take a simple example. Suppose a new electric light and power company is organized to serve a given territory and that the cost of developing the power, transmitting it, and distributing it to the homes and industries of the region is one million dollars. Under the definite plan proposed by the minority report this million dollars would be raised, let us

say, by bonds which would be entitled to the actual rate of interest on the bonds, say five per cent; in part by preferred stock which would be entitled to the actual rate of interest, say six per cent; and in part by common stock which would be entitled to say seven or eight per cent. This would mean that the rate would have to be high enough to pay this interest and these dividends, say an average of six per cent, or a total of sixty thousand dollars profit to the company in the first year.

The Public Service Commission would also allow an annual sum to retire the bonds, so that as the net result if the bonds ran, say, for thirty years, and amounted to one half the financing, and if there were no replacements out of depreciation reserve, the capital of the utility company at the end of thirty years would be only half a million dollars, because the bonds would be retired, even if the property were then worth less. In other words, at the end of thirty years the public in paying for this electric light and power would only have to pay enough to give about thirty-five thousand dollars of profit to the stockholders of the utility company.

Now let us see what is done by some utility companies operating under the present laws, or rather lack of laws. The same company, in the same territory, capitalized for one million dollars, gets the same part of this capital through the issue of five per cent bonds, through six per cent preferred stock, and by seven or eight per cent common stock, but it demands at once that it be allowed a seven or eight per cent return on the whole million dollars. This means that it is getting twelve, fourteen or sixteen per cent on the common stock, and this common stock is usually held by the insiders in the company.

Next, under existing laws, the company fails to retire a portion of the bonds each year so that at the end of thirty years, the life of the bonds, they are refunded by issuing new bonds and running them another thirty years. Thus, the public has to continue to pay for all time on the original capital structure. In this example, the public would be paying at the end of thirty years from \$170,000 to \$180,000 instead of \$35,000 under the bond-retirement principle.

But, this is by no means all. In many cases in the United States, through the mysteries of so-called accounting, com-

panies have been allowed to set up each year very large depreciation reserves and instead of having these depreciation reserves deducted from the original cost of the plant, these depreciation reserves have been actually added to the capital structure. Bear in mind that these depreciation reserves are paid for out of the monthly bills which are sent to you, the consumers. This method may mean very easily that at the end of thirty years a depreciation reserve may amount to one-half the original investment cost so that you are paying a profit on one and one-half million dollars instead of on a million dollars.

But still this is not all. Under the lack of a plainly stated policy by the state governments as to what the rate base shall be, the Supreme Court has gradually allowed the inclusion of large additional amounts in the rate base, based on what it would cost to reproduce the plant anew after many years have elapsed. This means that if a dam or power house actually cost only half a million dollars when erected twenty years ago it would now cost twice that amount to reproduce. The utility company could add one-half million dollars to this rate base, a straight out-and-out gift of that amount to the utility company stockholders. Suppose then, that in the case of our million dollar utility company half a million dollars were added by this wholly illogical depreciation reserve addition, and another half-million dollars were added by the reproduction of plant theory, even though the old plant continued to be operated; we would have a rate base of two million dollars instead of a rate base of half a million dollars under the proposed investment theory.

Put it another way. On two million dollars the users of electricity in our homes would have to pay seven or eight per cent, or \$140,000 to \$160,000 a year of profit to the company,* instead of \$35,000 a year under the proposed new set-up. It is perfectly evident that the difference between \$35,000 and \$140,000 to \$160,000 means not only much higher electric light bills to the consumers but also profits to the original common stock investors which would be not seven or eight per cent on their investments but anywhere from twenty-five to fifty per cent.

That is why I am insisting that this state should return to the original theory of granting a reasonable return and only a reasonable return to the owners of utility companies.

Let me give you some very simple figures, prepared by one of the great New York papers, which show graphically the importance of this question of state regulation. Generally speaking, the people of our state are paying higher rates for electricity in their homes than the people in most other sections of this country and of Canada. And even within our own state the prices charged for electricity have an absurdly wide range. These figures are based on the monthly use of 250 kilowatt hours of electricity, an amount that would permit the occupants of an average four-room house or apartment with one thousand square feet of floor space to light their home and also to use the following electrical equipment—an electric flat-iron, toaster, vacuum cleaner, electric fan, washing machine, ironing machine, radio, sewing machine, refrigerator, and last but by no means least, an electric range. This family living in Manhattan would pay \$17.50 a month; in Brooklyn, just across the East River, only \$13.40; in Staten Island, just down the bay, \$11.55. In Buffalo the family would only pay \$5.50; and in Albany \$9.30.

If this family living in Ontario, on the Canadian side of Niagara Falls, they would pay \$2.79; but if they lived on the American side of the Falls they would pay \$5.50. If they lived in Dunkirk, N. Y., a city owning its own municipal plant, they would pay \$6.93; but in Oswego, which has a private plant, they would pay \$11.20.

In Ithaca, in Bronx County, in Westchester County, and in several other parts of New York this family would pay over \$20 a month and as high as \$23.70, whereas if they lived almost anywhere in the province of Ontario they would pay less than \$3 a month.

- This, mind you, is not an argument on my part for every city in this state to embark right away on a program of municipal ownership. The spread in rates merely indicates that there is something wrong with our present method of supervising private ownership. I realize full well that this great problem cannot be successfully solved in one year, or in two years. Like most great problems it will take several more years of presentation of the simple facts to the average citizen,—not just to experts and courts and trained accountants. The facts are there in simple homely terms.

You will be inundated with all kinds of propaganda which in the past has been extended even to our public schools and people will try to befog and becloud the simple issue.

The straight question for you and for me to ask is whether we are going to return to the three-hundred-year-old distinction between a company engaged in wholly private business and a company engaged in a monopoly of a service which must be used by all of our citizens, rich and poor alike—a monopoly which exists by the grace of you and me through the charters which we have granted.

There are two methods of restoring reasonable rates for electricity and telephones in this state; and I say advisedly that I consider the rates charged to householders for these commodities are today too high and unless we act definitely and promptly they are going even higher. One of these methods is to allow and restore competition either by encouraging new companies to enter the field or by setting up at least as a yardstick more municipally operated companies, especially in the electrical field.

I think it is an established fact that those municipalities in the United States which have their own municipally owned companies providing the light and power for their citizens give just as good service and much lower rates than almost any of the privately owned companies. The yardstick of municipal operation is the question of success. The municipally owned companies are today almost all successful and the yardstick which they have furnished us proves that the rates of most of the privately owned electric companies are too high.

The other method which can well go hand in hand with the first is to give the Public Service Commission a definite rule for valuation and to make it obligatory on the Public Service Commission to fix rates in accordance with this definite set standard and no other. Let me say that this is not and should not be a matter of politics. If it becomes such, it will not be through my action, but nevertheless it is an issue, and I hope that the two major parties will not line up on different sides of this issue. It is an issue between two schools of thought. One school would return to the fundamental principle that a public utility is the creature of the state, that it must give

service and that it can and should earn a reasonable return on the investment which it has made and no more. The other school of thought would have us believe that a public utility company is essentially a private business operated for service perhaps but operated in such a way that through swollen valuations past, present and future it can make the public pay rates on two and five and tenfold the amount of money which was actually invested.

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